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into
Residential Tenancies

Rent Regulation: Design Characteristics and Effects

W. T. Stanbury and I. B. Vertinsky

Research Study No. 18

RENT REGULATION:
DESIGN CHARACTERISTICS AND EFFECTS

by

W.T. Stanbury and Ilan B. Vertinsky

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PREFACE AND ACKNOWLEDGEMENTS

This study is one of several financed by the Ontario Commission of Inquiry into Residential Tenancies as part of the second phase of its work. We had only four months in which to complete our work. Given our teaching commitments from January until early April, the deadline of mid-May 1985 left little time to digest and reflect upon what we wrote. Subsequently, we were able to reflect upon our analysis and to revise the study in numerous small ways.

We are conscious of the debts we have incurred in undertaking this study. We wish to thank John Todd, Director of Research for the Commission, who first formulated the basic idea for the study and who offered helpful insights, comments and ideas throughout its production. Don Jack, Counsel for the Commission, provided many useful suggestions in an effort to make the exposition clearer. He also was a most helpful guide to the intricacies of the present system of rent review in Ontario.

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We retain responsibility for all errors and misinterpretations that remain.

W. T. Stanbury

and

Ilan Vertinsky

Vancouver, B.C.
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Chapter 1

INTRODUCTION

1.0 THE CONTEXT

Ontarians have lived with rent controls for a decade. At present, about 830,000 tenant households (out of a total of 1.1 million) representing about 1,743,000 persons (out of a population of 8.8 million), live in rent-controlled dwellings. Therefore, one-fifth of the province's citizens have a direct experience with and a direct stake in rent control.

In its Second Phase, the Commission of Inquiry into Residential Tenancies moved beyond an examination of the existing system of rent regulation in Ontario (see Thom, 1984) and the possible objectives it may serve (see Stanbury, 1985a). It focused upon alternative modes of such regulation and on possible changes in related public policies such as government subsidies for rental housing. The Commission also dealt with the matter of how possible changes in policies can be most effectively implemented and at what cost.

Even a cursory study of rent regulation in other jurisdictions suggests that they are composed of a wide variety of design characteristics or attributes arranged in different combinations. At the same time, it appears that most rent control schemes have, in functional terms, certain common elements. In this study we examine the relationship between a rent control scheme's design characteristics and its effects. In Chapter 6 we review the most important studies of the positive and negative effects of rent regulation in Ontario. This chapter, along with those that precede it, should be helpful to the Commission because it is likely that the changes it recommends will consist of altering one or more of its characteristics with a view to improving the performance of Ontario's system of rent control in a particular way.

The task of the Commission of Inquiry into Residential Tenancies, established late in 1982, is, inter alia,

- to determine "the effect of rent review on the level of rental rates and the supply of residential accommodation in the Province";
- "to recommend such changes in the laws, procedures and processes ... [that] are necessary and desirable to provide for a fair and equitable treatment of landlords and tenants under a system of rent review"; and
- "to recommend what measures, in addition to rent review, the Province of Ontario might take to assist in providing rental accommodation at fair rents...".

2.0 FOCUS

The central question this study tries to answer is whether in theory and empirically it is possible to identify the relationship between the design characteristics of a specific system of rent regulation and the effects they produce, e.g., the level of rents in the controlled sector; the level of maintenance; and the supply of new rental units. We appreciate, a priori, that this is a formidable task. For example, it is suggested by some analysts that all systems of rent controls, if they do produce a significant gap between the rents of controlled units (R_c) and the market clearing or equilibrium level of rent for such units (R_e) will, in time, produce similar adverse effects. These adverse effects include a decline in the supply of new rental units, a decline in the real capital value of rental buildings in the controlled sector, a decline in the level and quality of maintenance and repair of controlled units, and an erosion of the tax base of local governments.

The supporters of "moderate" or second generation rent controls contend that these adverse consequences need not occur -- and have not occurred -- where the system of controls incorporates (or omits) certain design features. For example, it is argued that where newly constructed units are exempt, the future supply of rental units will be very little affected by the existence of rent controls. It is also argued that a control system can easily ensure that landlords receive an "adequate" return on their investment. Hence, they will have little or no incentive to restrict the supply of housing services produced by the rent-controlled stock of dwellings. In other words, it is argued that it is possible to operate a rent control scheme under which landlords have an incentive to maintain their buildings at the same standard as they did in the absence of controls -- while at the same time holding rents below the market-clearing level.

To understand this issue and a host of related ones we have studied systems of rent controls in a number of jurisdictions in North America and, to a lesser extent, in other parts of the world. In order to keep the length of the study within reasonable bounds we have devoted more space to rent regulation in Ontario - see Chapters 5 and 6. However, in preparing the more general analyses in Chapters 2, 3 and 4 we examined in some detail the following jurisdictions:

- **New York City:** See Clapp (1976); Hsia (1974); James & Lett (1976); Kristof (1975), (1981); Lowry (1971); Lowry et al. (1971); Lukashok (1972); Marcuse (1979); New York City Rand Institute (1970); Note (1967), (1970); Olsen (1972); Stegman (1982); Sternlieb (1972); Sternlieb & Hughes (1976); Ungar (1979).
- **Massachusetts:** See Achtenberg (1981); Selesnick (1976); Eckert (1977); Laverty (1976); Leonard (1981); Navarro (1980); Sternlieb et al. (1974).
- **California:** See Appelbaum (1983); Clark & Heskin (1982); Clark et al. (1980); Gupta & Rea (1984); Kirlin & Frates (1979); Partrick (1978); Rea & Gupta (1982b); Rydell et al. (1981).
- **New Jersey:** See Baar (1977); Gilderbloom (1983a), (1984b); Gilderbloom & Keating (1982); Kochanski (1980).

- **Several U.S. jurisdictions:** See Gilderbloom (1980), (1981a), (1981b); Gilderbloom & Appelbaum (1984); Lett (1976a).

3.0 SETTING THE STAGE

In this study we examine this issue and a host of related ones. Before we move to the details of the analysis in Chapters 2 through 7, it is necessary to set the stage for the study as a whole.

(i) Rent control appears to be deeply entrenched in Ontario. All three political parties support it, although with different degrees of enthusiasm. The Progressive Conservatives, only two days before the last general election was called, proposed to make controls more stringent -- see Chapter 5. A survey of 500 tenants and homeowners in Ontario's ten Census Metropolitan Areas in early 1984 found that 13% of tenants and 21% of homeowners thought rent control should be abolished and 73% of tenants and 58% of owners stated that rent control should cover all rental housing (Pringle, 1985, p. 182).

However, it is essential that citizens and policy makers in Ontario look beyond the status quo to see how the widely-held objectives of rent regulation can be met more effectively and at less cost to society. In doing this it is necessary to think beyond marginal adjustments to the system of rent regulation as it now operates in Ontario. As we document in Chapter 5, there have been numerous important changes in the system since it was enacted on December 18, 1975. One of the principal objectives of this study is to provide an analysis of the great variety of rent control systems that have been in operation in recent years. One cannot order the optimal meal without a look at the entire menu. The set of choices possible for improving rent regulation in Ontario is far larger than may yet have been appreciated.

In Chapters 5 and 6 of this study we devote considerable attention first to the design characteristics of rent control in Ontario and then to the effects of the system that has been in place for almost a decade. We do this for three reasons. First, we needed a detailed "test" of the general frameworks established in Chapter 2 and 3. Second, the task of the Commission of Inquiry into Residential Tenancies is to make recommendations regarding the Ontario system. This requires a deeper knowledge of the system that is to be improved than of the range of possible alternatives. However, the greater detail on the existing system in Ontario should not be construed as an endorsement of the status quo, but a recognition that most important public policies change only incrementally and necessarily in terms of adjustments to the present system. Third, although rent controls have been in place in some jurisdictions for many years (e.g., New York) there is more detailed information available concerning controls in Ontario. Therefore, we have sought to capitalize on this information both to understand the "cause and effect" of controls in Ontario, and to obtain insights into the relationship between the design characteristics and effects of rent control in general.

(ii) We emphasize that the actual effects of any system of rent control will depend on a number of factors not embodied in the system of regulation. These include shifts in the demand for rental accommodation, and the nature and scope of related government policies such as construction subsidies for new rental units, and zoning controls. For example, a particular system of controls may have only a modest effect on new supply, maintenance levels, and the rent gap between the controlled and uncontrolled sectors if macro-economic policies are such that the demand for rental housing declines. In other words, under certain conditions a system of controls may not constrain rents very much and therefore have few adverse effects often ascribed to rent controls. Even where there is excess demand in the rental housing market for some time (evidenced by low vacancy rates), some of the likely adverse consequences could be offset by large-scale government assistance to the rental housing market. For example, the supply of new rental units may be increased substantially by new subsidy programs, bigger "tax expenditures" (e.g., tax deductions for capital investment in new rental buildings) or by liberalizing zoning and building codes. Such policy actions may increase the supply of new units, but over the longer term the structure of the rental housing market will change toward greater dependence on public funding. In this way, part of the total cost of rent controls will be broadened, i.e., paid by all taxpayers rather than largely by landlords at the time controls were imposed.

(iii) Rent regulation is a form of government intervention that is particularly contentious. It is an issue upon which there are clear ideological cleavages as well as the usual divisions associated with programs that are designed to redistribute income. These economic and philosophical differences extend throughout the range of issues associated with rent control as a public policy: objectives, alternative methods of implementing controls, and the effects of rent control. See Stanbury (1985a) and Stanbury and Thain (1986).

(iv) We have found that it is often the case that the proponents and critics of controls use different analytical paradigms in discussing rent controls. We have also found that, in effect, they work with different assumptions as they move through their analyses. The problem is that very few writers on the subject of rent controls state the full set of assumptions that underlie their own observations. Therefore, in Chapter 4 we present three different but complementary frameworks in which to analyze in theoretical terms the complex relationships between the design characteristics and the likely effects of systems of rent regulation.

(v) We emphasize that in political and social terms the timing of the effects of a rent control regime is of great importance. We note that despite spending over 8% of the GNP on health care we all end up dead. People in the U.S., which now spends 11-12% of its GNP on health care, meet the same ultimate fate. But that is not the point. The issue is when we meet our fate and how we get there, i.e., painfully or pleasantly. So it is with rent controls. As we shall argue in Framework 1 of Chapter 4, in the long run it is virtually impossible for a system of rent controls to prevent rents from moving toward the equilibrium or market clearing level. However, controls can alter the speed with which equilibrium is achieved (i.e., slow the pace of adjustment). They can also influence the shape of the path of adjustment to shifts in demand and supply in rental housing markets. Because the short run elasticity of both the demand for and supply of rental housing is very low, small shifts in either demand or supply can have a large impact on rent levels. This is particularly true with an increase in demand. Behavioural factors appear to have the effect of transmitting excess demand situations into rent effects more quickly than a corresponding excess supply situation.

In any event, as in many other areas of life, timing is of great importance in the matter of rent increases. For example, if, ceteris paribus, the control scheme can be designed so that any adverse impact on maintenance can be delayed by more than a decade or the gap between rents in the controlled and uncontrolled sectors will not exceed 25% for a decade, this is a valuable gain to society as well as to the politicians who must ultimately alter or remove the system of rent regulation. (This is not to say that there are no costs associated with delaying rent increases or declines in maintenance.)

In politics, timing is of the essence. Not surprisingly, politicians fully aware of the long-term adverse consequences of rent controls, could still vote for them to reduce the rate of increase in rents below the rate of inflation this year and next year. This is rational behaviour because the current beneficiaries are likely to greatly outnumber the current losers and because when the "chickens come home to roost" the electorate may not be able to connect an initial vote for rent controls with the problems they may have created. Ultimately, politicians console themselves with the idea that if they do not impose rent controls someone else will do so and they may be tossed out of office and therefore no longer be able "to do the Lord's work" in other areas of public policy that are more important.

(vi) Is rent control an example of the "rose is a rose is a rose" phenomenon? Or do we find, upon closer inspection, that there are a large number of variations among the flowers we call roses? The analysis contained in the chapters that follow will indicate that while there are certain strong family resemblances among various systems of rent controls, there are also sufficient individual differences to suggest that these variations may be significant. For policy making purposes the critical issue is whether there is a systematic relationship between specific design characteristics and specific effects of rent regulation.

Second, the critics of controls say that even if a particular system starts out as limited in duration and only moderately restrictive, the dynamics of political and administrative behaviour mean that controls will become permanent and gradually become more restrictive. This will occur regardless of the original intent of legislators who have often acted in the face of what they believed was a "temporary emergency". The fact is that two years of temporary controls, for example, create strong economic and political interests in their extension in time and scope. See Stanbury and Thain (1986, Ch. 9). Moreover, in a democracy characterized by the supremacy of parliament, it is impossible for the governing party -- even with unanimous support -- to bind itself or its successors from extending rent controls in the future. (The events of 1985 illustrated this point. See Stanbury and Thain (1986, Ch. 9). Even a constitutional provision only makes an extension of controls more difficult, but not impossible. When political pressures are great -- and rent control is an issue that uniquely combines raw emotion and pecuniary interests -- previous promises will be forgotten in the politician's desire to respond to "the will of the people".

On the other hand, even with the best of intentions, the advocates of rent controls are not able, as King Canute demonstrated to his courtiers, to hold back the tide of fundamental economic forces. The imposition of any form of price controls creates a set of forces that are all but impossible to overcome by the administrative decision making of a regulatory agency.

(vii) We think of a particular system of rent regulation as a set (or vector) of design characteristics, most of which may take a number of alternative forms. Therefore, we can represent a system of rent regulation, S, as follows

$$S = (C_1, C_2, C_3 \ldots C_n)$$

where C_1, C_2, etc., are design characteristics such as

- the universe of controls (scope and exemptions);
- the base rent;
- method of determining allowed increases in rent;
- rules regarding tenant's security of tenure, etc.;
- various administrative characteristics:
    - organizational structure of the regulatory agency;
    - scope of responsibilities of the regulatory agency;
    - adjudicatory characteristics;
    - appeal provisions; and
    - enforcement.

However, each characteristic (C_i) may take a number of alternative forms. For example, there are potentially an infinite number of methods of determining the allowed increase in rent. Just a few include:

- a fixed percentage established by the legislature and applied to all rental units;
- a percentage that varies annually and is established by an elected regulatory body; and
- an increase based on individual landlords' increases in costs as justified before a quasi-judicial tribunal.

We can also think of the effects of a system of rent controls as a set or vector

$$E = (e_1, e_2, e_3 \dots e_n)$$

where e_1, e_2 ... e_n are such potential effects as:

- the gap between rents in the controlled sector (R_u) and the uncontrolled sector (R_u);
- the change in the level of maintenance activities;
- the future supply of new rental units; and
- changes in the mobility of tenants.

In modifying the system of rent controls in Ontario policy makers need to know how much "room to manoeuvre" they have in terms of:

- economic relationships in the rental housing markets;
- the behavioural responses associated with the administration of rent controls; and
- the political realities of rent control.

Is it possible, for example, to design and operate a system of rent controls that eliminates "gouging" in periods of excess demand and, at the same time, prevents such adverse consequences as reduced supply of new rental units, a decline in maintenance and the erosion of the controlled rental stock? The advocates of "moderate" controls answer this question in the affirmative while the strongest critics deny it is possible to avoid such adverse consequences. The critics appear to reach their conclusion for two reasons. First, to the extent that controls create a substantial gap between controlled rents and those that would occur in the absence of controls, the rate of return on landlords' investment will be reduced. Therefore, landlords will seek to get their controlled units out from under controls; they will reduce the supply of housing services from existing units by reducing maintenance. And potential investors will be discouraged from building new rental units. In other words, rent controls create adverse economic incentives for existing and future landlords which may vary in degree, depending on the particular regime, but which move in the same direction.

4.0 STRUCTURE OF THE STUDY

Part I of this study following this introduction contains three chapters in which we present a general framework for analyzing the full range of systems of rent control. Chapter 2 offers a categorization of the design characteristics of systems of rent regulation. We suggest that all control regimes contain two principal sets of provisions: substantive, and procedural. In functional terms, the regimes must establish the rules which define the universe of controls in both static and dynamic turns; they must define the base rent and how increases in that rent are to be determined; and they must establish rules governing the general relationship between landlords and tenants.

Chapter 3 identifies the potential economic and behavioural effects of rent regulation and classifies them. Three main categories are proposed: allocative effects (i.e., on prices and quantities); distributional effects, notably on the distribution of income; and secondary effects which include the impact of controls on government revenues and expenditures, tenant mobility, and various non-price rationing effects.

Chapter 4 is the most ambitious. We attempt to identify the linkages between key design characteristics and the key effects of rent regulation by means of economic and behavioural theory. The analysis is conducted within three different but complementary frameworks. Each framework consists of a set of assumptions about the time period, availability of information to the system's actors, the fidelity of the system in practice to the ideals of the regulatory regime, the degree of economic rationality of the actors, and whether or not intertemporal dynamics are taken into account. We show that the linkages between selected design characteristics and effects depend quite heavily upon the framework of assumptions with which the analysis is done.

Part II of the study applies the analytic framework developed in Part I to the current system of rent regulation in Ontario. Chapter 5 examines the system's design characteristics using the categorization developed in Chapter 2. Chapter 5 also shows the evolution of each design characteristic over the decade controls have been in place. In addition, we describe the nature and volume of administrative activities under the two different regulatory bodies that have been responsible for rent regulation in Ontario since it was enacted in December 1975. Chapter 6 uses the system of classifying the effects of rent regulation developed in Chapter 3 to assess rent regulation's effects in Ontario to date. The chapter is lengthy as we have tried to review all the major studies including their methodologies.

We hope that a deeper understanding of the present system in Ontario, how it has evolved, and its effects will make the Commission of Inquiry's task of recommending changes in public policy easier. We emphasize that rent control is a policy embedded in a web of other related social and economic policies, e.g., subsidies for new construction. Rent control also must necessarily take into account macro-economic conditions and demographics, e.g., new household formation.

Finally, we come to Part III which tries to draw together the many strands of the study into our conclusions for public policy in Chapter 7. We are conscious of the mixture of positive and normative elements that are involved. Therefore, we have tried to make our value judgments explicit. Our focus is on outlining some alternative designs for modifying the regulation of rents in Ontario.

Chapter 2

THE DESIGN CHARACTERISTICS OF SYSTEMS OF RENT REGULATION

1.0 INTRODUCTION

The purpose of this chapter is to provide an analytic structure within which one can classify and understand the essential elements of any system of rent regulation. As we noted in the previous chapter, we think of any system of rent regulation as a vector of particular characteristics.

A design of a system of rent controls includes two principal sets of provisions: (i) the substantive provisions of a rent control statute, and (ii) the administrative machinery to implement the control regime. The substantive provisions must include: (i) a definition of the universe of the control system (i.e., the units subject to control) and the circumstances under which this universe will change, (ii) a criterion or mechanism for the determination of the base rent and the mechanisms for subsequent increases in rent levels (if any), and (iii) provisions to regulate the interactions between tenants and landlords -- these may include security of tenure provisions, information provisions and notice requirements.

Clayton Research (November 1984, Appendix, pp. 36-37), in its review of the characteristics of provincial rent control systems in Canada, focused on the following design characteristics:

- exemptions for privately-owned units,
- changes in the exemptions for privately-owned units,
- the method of determining allowable rent increases,
- the treatment of capital improvements and major repairs, and
- the treatment of changes in financing costs.

Rydell et al. (1981, p. 41) argue that "any of the rent control laws that have been enacted can be almost fully characterized by the answers to five questions:

- How long will the law be in effect?
- What is the coverage of the law -- which dwellings are subject to it, which are exempt?
- What rent increases are permitted for continuing tenants -- that is, if a dwelling does not turn over, how much can the landlord raise the current tenant's rent?
- How much can landlords raise rents when their dwellings do turn over?
- Under what circumstances does a dwelling become permanently decontrolled?"

We note that this list of key design characteristics does not include the details of possible cost pass-through provisions particularly as they relate to maintenance expenditures and changes in financing costs.

Partrick (1978) identifies the following design characteristics in systems of rent regulation:

- the nature of exemptions from the control regime;
- the method of setting base rents including rollback provisions;
- mechanisms for subsequently adjusting rents (return on investment formulas; flat or variable percentage increase with or without cost pass-throughs for tax increases, capital improvements, etc.; evaluation of individual cases; and hardship rent adjustments);
- the nature of controls over eviction; and
- other provisions such as administration, funding and enforcement, termination date, and mechanisms to prevent deterioration of the rental stock.

In addition to the substantive provisions the design must specify the administrative machinery responsible for implementation. These provisions must allocate responsibilities for both operating the system and policy formulation. Second, the design must specify the basic standards which must be applied to the process of administering the system of controls (e.g., the rights and standing of different participants in the process). Third, it must specify the means for acquiring resources to operate the system and the auxiliary constraints on the operation of the system (e.g., specification of types of personnel) and additional duties (e.g., maintenance of a rent registry or research program). Fourth, the design for a system of rent controls must specify the powers of enforcement given to the regulator and the resources to be devoted to enforcement.

The set of design characteristics chosen must reflect the objectives of the system of rent regulation, its expected duration, and the nature of the rental housing market to which they apply. They must also be feasible. First, the design must conform to the law (e.g., delegation of regulatory authority must respect the constitutional allocation of jurisdiction between different levels of government). Second, in the design there must be a match between resources available to the system of regulation and its responsibilities. The violation of these criteria of feasibility may result in immediate failure or at least a severe delay in implementation. In our analysis we will consider only the second criterion, although we note that in the U.S. the first criterion can be very important. See Baar (1977) and Partrick (1978).

The match of a rent control system's design characteristics and its objectives is more difficult. Since many systems involve multiple objectives, trade-offs among objectives are usually necessary. A design characteristic which enhances performance in terms of one program objective may lead to deleterious results in terms of another objective. For example, the administrative objective of implementation efficiency may imply the application of simple, standard formula for rent increases. The application of such adjustment mechanisms, however, will create inequities since no two participants in the rental housing market are identical. Thus, the requirement for simplicity and efficiency will violate the requirement for equity - see the discussion below. Another hurdle in the design of a system of rent controls is the fact that certain characteristics may bring about different consequences at different points in time. Thus a measure designed to reduce the rate of increase in rents in the short run may indeed achieve this objective, but it may do so at the cost of higher increases in rents in the long run, or it may have undesirable spill-over effects in other markets.

In developing alternative designs for systems of rent regulation it is desirable to consider first the choice of each design characteristic in terms of its prime function or contribution to the control system as a whole. This will permit us to generate sets of coherent alternative control systems for further evaluation in the decision process. As we explained in Chapter 1, any system of rent control can be thought of as a vector or set of particular design characteristics. All systems must perform certain functions if they are to "work" in the sense of holding rents below the level that would prevail in the absence of controls. However, how a particular function is performed may be of considerable importance in determining exactly how a system operates and what effects it produces, all other things being equal. Therefore, the first order question is to determine what functions a provision serves and the second order question is to determine the alternative ways in which it may be performed.

2.0 SUBSTANTIVE PROVISIONS

2.1 Four Types of Rules

The specific types of substantive rules required for a complete design for a system of rent controls are as follows: First, there are the rules which define the scope of the system, i.e., the extent and types of exemptions. Are rented single family dwellings to be subject to controls? Are "luxury" rental units to be exempted? The legislation as originally proposed in Ontario in 1975 would have exempted rental buildings with four or fewer units. However, pressure by an opposition party extended controls to cover even single family dwellings that were being rented (Stanbury and Thain, 1984, Ch. 8).

Second, there are the rules designed to achieve a basic impact on most units covered in terms of the objectives of the control system. Clearly the most important are the provisions concerning the size of the allowed periodic increases in rent. The impact of these general constraints depend on external circumstances (e.g., the rate of increase in landlords' costs, vacancies), and the designed tightness of the constraint. For example, in a market with high vacancy rates and 4% rate of increase in landlords' costs, an allowed increase of 6% may not be overly tight. The attraction of using provisions with a broad coverage is economy and immediacy of implementation. But broad provisions usually result in imprecise targeting. We must emphasize that the design of rent control systems necessarily involves hard choices about critical characteristics. For example, simplicity must be traded-off against vertical and horizontal equity. The measurement of a system's efficacy is often determined in terms of the stringency of its rules, for example, the degree to which rents were reduced from the level they would have reached without controls. However, greater stringency in this sense will also increase allocative inefficiency.

Third, there are rules designed to focus the impact of the control system, to provide for exceptions to the application of general constraints, and to authorize the means for specific adjustments necessary to ensure that long-term goals are achieved including that of equity. For example, rent regulation can provide the means to protect the existing rental stock from undue deterioration by means of cost pass-through provisions and corrections for financial hardship. These can provide significant adjustments, but in any particular year they may cover only a significant minority of rental units. For example, in 1983/84 rent review in Ontario approved increases on a cost pass-through basis for only 106,472 units out of the approximately 839,000 units subject to controls. The measurement of a system's deleterious effects and its efficacy will provide an assessment of the success of these rules in achieving the system's targets (e.g., to increase the affordability of housing by focusing the benefits of the system on low-income tenants) or in preventing counter-productive behaviour (e.g., the preservation of "normal" maintenance levels).

Fourth, there are rules which respond to specific types of behaviour that are deemed to be socially undesirable and which result from the provisions in the third category. These rules are designed to plug possible "loopholes". Examples are the constraints on the costs that may be passed through when they result from recent transfers of ownership of a rental building (e.g., the costs of new financing). Significant change in certain types of market behaviour (e.g., high turnover of ownership) provides the system's administrators with signals of loopholes to be plugged. This occurred in Ontario following the Cadillac Fairview/Greymac/Kilderkin affair (see Corcoran & Reid, 1984) which resulted in the 1982 Interim Act which is described in Chapter 5. See Stanbury (1985c).

2.2 Discussion*

Clearly those rules that define the scope of coverage and the rules designed to have a general impact constitute the core of any system of rent regulation. If tight general constraints upon increases in rents are envisaged for a significant percentage of the rental market, the design must provide an "escape-hatch" and a series of measures to combat the inevitable distortions and inequities that will result so long as excess demand persists or as long as landlords' costs are rising substantially. This statement assumes that rent increases are to be held below the rate of increase in landlords' costs, that the initial rent level was not above the equilibrium level and that it is the existing stock (but not new construction) that is subject to controls.

Rules designed to have a broad impact have certain virtues: they usually can be implemented quickly, require lower information inputs and impose lower transaction costs on tenants, landlords and taxpayers. They can have a major influence on the average rate of increase in rents. In a cyclical economy, moderate general constraints on rent increases can provide an effective device to "smooth out" what would otherwise be very sharp increases in rent because of the low short-run elasticities in both demand and supply. Controls can moderate rent increases in periods of excess demand and facilitate the closing of the rent gap** when the rental market is slack. It appears that the strongest argument for controls in both political and economic terms is that they are needed to prevent very sharp increases in rent during periods of excess demand or where landlords' costs are rising very rapidly -- see Stanbury (1984a, Ch. 2). It is important, however, to distinguish between general, short-term controls on the rate of increase in rents relative to changes in costs, and controls designed to hold average rents below their equilibrium level in the long run.

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* The purpose of this and future "discussion" sections in this chapter is to highlight some of the elements of systems of rent regulation set out in the section preceding them. The discussion is not intended to be exhaustive as that would make the chapter overly lengthy and make it harder to see the larger picture.

** The rent gap is the difference between the controlled rent (R_c) and the higher rent that would occur in equilibrium (R_e) in the absence of controls.

Rules which permit eventual deregulation (e.g., by vacancy decontrol) or exemption of certain segments of the market (e.g., new rental buildings) tend to reduce counter-productive responses such as a reduction in the supply of new rental buildings and disinvestment activities by owners of the existing stock. Vacancy decontrols have the virtue of protecting sitting tenants, while providing landlords with an opportunity to increase rents to market levels when a tenant moves out, thereby reducing the incentive to defer conservation activities or convert the building to other, non-controlled uses. Vacancy decontrol, however, rewards immobility and permits a form of discrimination against newcomers to the area. It also provides incentives to the landlord to reduce the supply of rental housing services and cosmetic maintenance. (For more details, see Chapter 4.)

Limiting the scope of legislation in time ("sunset" rules) is one important means of influencing the expectations of landlords and therefore of reducing some of the economic distortions usually caused by rent controls. However, as has been repeatedly emphasized, getting out of controls is much harder than getting in. In Ontario, for example, the original legislation enacted on December 18, 1975, retroactive to July 30, 1975, was to expire on August 1, 1977 (see Stanbury and Thain, 1986). It was subsequently extended for short periods several times and then made "permanent" in late 1979. Controls were enacted in New York City in 1947. While they have been modified several times since then, over 70% of the rental stock is subject to some form of rent regulation. See Stegman (1982).

Except as an emergency measure, the introduction of severe rules of general impact (e.g., a total freeze) is typically accompanied by rules that provide for exceptions to the general provisions. These exceptions are necessary to ensure that long-term goals are achieved and to maintain the overriding principles of fairness and justice. For example, in Ontario landlords can apply for a hardship increase if their gross revenues do not exceed their cash expeditures by at least 2%. We note in Table 5-3 that in the last five years between eight and eleven percent of all applications for a whole building review involved claims for relief of financial hardship. Such a provision should have the effect of reducing the incentives of landlords in financial trouble to reduce all variable expenditures including maintenance, thus reducing the quality and quantity of housing services -- see Chapter 3. However, there is no evidence to suggest that the present hardship allowance in Ontario is either the right amount to solve the problem, or that it provides the appropriate incentives. We emphasize that if the rental stock is old, the failure to maintain buildings amounts to the systematic destruction of the housing stock, an important component of the nation's wealth.

Rules of general impact may, of course, be devised in a way that requires unit-by-unit adjudication (e.g., as proposed by the Rand Corporation for New York City - see Lowry et al., 1971). As we shall argue later, the administrative costs of a system of unit-by-unit adjustment become prohibitive unless the coverage of rent controls is highly restricted. For example, the rent regulation system in New York was forced to abandon annual or bi-annual, unit-by-unit calculations and instead resort to general maximum allowable increases. See Ungar (1979), Hsia (1974), and Stegman (1982).

The design of a system which provides for exceptions to the general rules must consider the incentives that such provisions create for landlords to engage in socially undesirable behaviour to escape some of the adverse effects of controls. The existence of potential loopholes has short-run benefits in shaping the expectations of landlords by reducing incentives for disinvestment. In the long run, however, when the cumulative gap between controlled and equilibrium rents becomes sufficiently large, landlords will have a greater incentive to take advantage of any means to escape controls.

High rates of conversions, refinancing and changes in ownership have triggered, in many systems, amendments to existing rent regulations in order to discourage, or forbid such activities. The fact is that rent controls amount to a highly discriminatory tax on the owners of rental property when they are introduced or made more stringent. It is naive to expect landlords not to try to avoid paying the tax. It is naive also to assume that the drafters of the initial legislation can anticipate all the ways landlords may try to escape, to some degree at least, from the burdens of rent control. Hence every system of controls is a dynamic one. Each adjusts to experience - see Chapter 5 regarding the evolution of rent controls in Ontario. Amendments are made to close loopholes as they become evident, and they are also made -- albeit less frequently -- to reduce the stringency of the system when it is widely perceived that adverse consequences are occurring that also hurt tenants. This occurred in New York City, for example, See Lukashok (1972).

Finally, a system of rent controls must fulfill certain requirements of natural justice. It must protect individuals' rights generally, and specifically designate and protect their rights to fair and equitable treatment in matters concerning rents and tenancy. While the definition and protection of security of tenure is a basic condition of existence for a rent control system -- see Stanbury (1985a) - rent controls also have a major impact on the property rights of landlords. In the haste to protect tenants, the rights of landlords are often abrogated, allegedly in the name of the welfare of society as a whole. In general, rent control must consider not only tenant and landlord rights, but also the rights of others which may be affected by the rental agreement (e.g., other tenants).

2.3 Substantive Rules in More Details

(1) The Universe of Controls (Coverage)

(a) Stock Rules: Those Relating to the Existing Stock of Rental Housing

What fraction of the existing rental housing stock is subject to controls? Alternatively, this characteristic can be looked at in terms of the scope of exemptions which may be defined in terms of the following characteristics:

- size of building, e.g., exempt all units in buildings with fewer than X units (e.g., Massachusetts exempts owner-occupied buildings with up to three units).
- rent level (e.g., Ontario used to exempt all units renting for more than $750 per month; the U.S. federal Wage and Price Control Program (1971) had a maximum exemption of $500 per month).
- class of ownership, e.g., social housing, non-profit housing, publicly owned units, educational institutions' student dorms, etc. This is a common exemption.
- use of premises, e.g., units occupied by a landlord, commercial premises, recreational use, etc.
- class of tenant, e.g., transient accommodations such as hotels, rooming houses.
- age threshold, e.g., buildings built before or after a certain date.

Discussion: The exemption of "luxury" units based on a rent level at a particular point in time is an easy means for focusing a rent control system's impact. If the exemption is fixed in nominal terms then one can interpret that the intention of such a provision is to bring about gradual decontrol. This is so since a unit which is not a luxury unit at a particular point in time, is not likely to become luxurious just because inflation results in higher rents. In the case of Ontario, for example, units renting for more then $750 per month were exempt from rent review between 1980 and late 1984. See Chapter 5.

The exemption of non-profit rental housing, publicly-owned rental housing, etc., reflects the notion that these types of housing are managed in accordance with "the public interest" and therefore duplication of controls is neither necessary nor desirable. In Ontario, "social housing" exempted from controls amounted to 13.6% of the rental stock in 1981 (Pringle, 1985, Figure 4.1).

The exemption of special purpose buildings used by business as boarding houses, hotels, etc., is motivated by the recognition of administrative difficulties in separating the "rental" component from other factors involved in the transaction. With respect to the problem of boarders, see Jaffray (1984).

(b) Geographic Scope of the Control Regime

- Are controls local in scope, i.e., city or metropolitan area? Or do they cover a province, or are they nation-wide?

Discussion: There are two conflicting concerns in determining the geographical scope of controls: (i) the size of the area, (ii) inter-regional coordination. If the geographic area subject to rent controls is small and is embedded in a larger urban area (housing market), the ratio of controlled units to total units may be small (e.g., Santa Monica versus metro Los Angeles) and the degree of distortion will be less from the perspective of the total market -- see Shulman (1981). However, the adverse effects (e.g., low vacancy rates) will be exaggerated if the controlled area is small relative to the total (regional) housing market.

Rent controls can be geographically decentralized. For example, in New Jersey each municipality has its own control legislation and co-ordination is informal -- see Baar (1977), Gilderbloom (1983a; 1983c), Baar and Keating (1975). This allows for local fine-tuning of controls but may lead to legislative balkanization. An alternative prototype is the approach in Massachusetts where the state legislation provides detailed enabling legislation (for municipalities with more than 50,000 people) but implementation is left to the local governments -- see Selesnick (1976), Sternlieb et al. (1974), Achtenberg (1981). Finally, one can take the Ontario approach where the whole province is covered by the control system but for internal administrative purposes nine regional districts were established -- see Thom (1984).

(c) Flow Rules

Can controlled units escape controls? When do units presently free of controls subsequently become controlled?

(i) New construction

- totally exempt forever (e.g., Massachusetts, but New York City provides a counter-example where some formerly exempted units were eventually covered by controls)*;
- exempt for a specific number of years, then the rate of increase in rents is subject to controls (e.g., in Quebec new units are exempt for five years); and
- subject to controls, but the initial rent level is at the owner's discretion, then the rate of increase in the future is controlled (e.g., most municipalities in New Jersey).

(ii) Conditions for de-controlling units

- a voluntary vacancy decontrols the rent level for the unit: (i) partial decontrol where controls apply to the subsequent rate of increase (e.g.,

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* This also occurred in Ontario in 1985. See Stanbury and Thain (1986, Ch. 9).

New York); (ii) permanent decontrol where subsequent rent increases are also exempt from control (e.g., Boston);

- when the rent rises under controls to exceed $Y per month the unit is no longer subject to controls (between 1980 and late 1984 this "luxury" provision applied in Ontario where Y = $750). Note -- in B.C. a separate level was set for different sized units (bachelor, 1 bedroom, 2 -bedroom, etc.);
- by age of building, e.g., when a rental building is at least N years of age, it then becomes exempt from both demolition and rent controls provided the new building contains a certain number of residential units;
- by renovation into a type of unit that is not controlled i.e., "luxury" units in Ontario - see Thom (1984, Ch. 4);
- contracting out of controls (e.g., in Hong Kong, landlords and tenants may contract out of controls);
- all controls exist only for a fixed period of time, i.e., there is a sunset clause; and
- a conditional sunset clause dependent upon specific economic conditions, e.g., level of vacancy rate, rate of increase in CPI, etc. In New York City, for example, rent regulation ceases to exist when the vacancy rate is 5% or more. See Stegman (1982).

(iii)Conditions for controlling previously exempt units

- fixed-term "holiday" (exemption) for units constructed after controls began, then subsequent increases in rent (not initial level) are controlled.

Discussion: In an attempt to avoid discouraging the construction of new rental units, newly constructed buildings are often exempted from controls. The exemption may be perpetual or temporary (a control 'holiday'). Lett (1976a, p. 92) comments,

> It is not apparent that even a blanket exemption encourages new construction since the housing industry is often fearful that the exemption may be withdrawn at a later date. In this regard New York City provides an example. After exempting all units constructed after February 1, 1947 in its original rent control law, twenty-three years later the City imposed rent stabilization regulations on these structures.

Under rent stabilization the size of annual rent increases is controlled -- see Stegman (1982).

Vacancy decontrols, "luxury" exemptions and decontrol upon dwelling renovation and upgrading are strategies for gradually decontrolling the rental stock.

Partial vacancy decontrol, i.e., temporary decontrol of a unit upon vacancy, is an effective means for protection of sitting tenants combined with periodic closure of the rent gap (R_e - R_c). (It can also lead to harassment of sitting tenants.)

(2) The Base Rent

The base rent upon which subsequent rent increases are compounded may be determined in a variety of ways:

- roll back to the level prevailing at a certain date (e.g., Massachusetts, Ontario);
- roll back with a fixed percent increment (e.g., Hong Kong);
- theoretical formula attempting to simulate long term market equilibrium (e.g., New York); and
- other theoretical or empirical formulae.

Discussion: The imposition of rent level controls assumes implicitly or explicitly that there is some desirable level of rent. "This determination is generally accomplished by the rollback of rents to a prior date .... The length of time of the rollback period necessarily varies as a function of the emergency conditions and the contingencies of enactment ..." (Lett, 1976a, p. 83). Since a rent control program does not occur unexpectedly, it is likely that landlords will increase rents in anticipation of controls. For example, in Ontario controls were publicly debated for at least six months before they were formally announced - see Stanbury & Thain (1986). A rollback provides a mechanism to prevent "speculative" rent increases. If rent controls are imposed because some emergency exists, a rollback may be justified on the basis that it establishes the "normal" rent. The assumption which is made is that at the reference date rent levels were in equilibrium. The advantages of a reference date rent as a base lie in the simplicity and objectivity of defining the base level for each unit.

Alternatives to a reference date include theoretical calculations of various kinds, typically attempting to approximate what a market long term equilibrium would have been without the emergency condition. This is typically an impossible task, but the impossible has never yet stopped a regulator. See Ungar (1979) and Hsia (1974) for a discussion of the Maximum Base Rent System in New York.

(3) Method of Determining Allowed Increases in Rent

(a) Amount of rent increase per period

- The allowable increase, percentage, is set in a statute (which can be zero) and not adjusted over long periods of time, i.e., not systematically related to incomes, landlords' costs, vacancy rates, etc. This approach was adopted in Ontario, Los Angeles, France -- 1964 -- total freeze; Holland -- a total freeze from 1940 to 1957; and Hong Kong rent was fixed at 1941 level plus 155%.
- The rate of increase is specified in the legislation, but in terms of a formula related in a systematic way to such variables as the Consumer Price Index, landlords' costs, vacancy rates, or growth in incomes,

property values, etc. For example, many New Jersey municipalities use CPI-related formulae. In the United Kingdom controlled units are allowed to increase as a function of rateable values at some specified periods before rent revision dates.

- General criteria specify that increases in rent be sufficient to permit the landlord to cover costs and to earn a specified rate of return. This approach amounts to some form of a rate-base-rate-of-return system somewhat analogous to public utility regulation. See the study for the Commission of Inquiry by Quirin and Waters (1985), also studies of Massachusetts which has various definitions of "fair return", and Santa Monica (Shulman, 1981).
- General provisions which state that increases in rent are at the discretion of the regulator in light of the statutory phrase such as "just and reasonable in the circumstances," or in light of a number of specified criteria.
- Periodic rent increases based on increases in costs. But which costs are included -- taxes, maintenance, interest on mortgages, administrative costs, etc.? How automatic is the pass-through? What is the treatment of capital items, i.e., the write-off rate and the interest rate? What are the incentives for maintenance expenditures at the margin? What is the treatment of changes in financing costs attributable to a sale/purchase, e.g., a maximum increase of 5% allowed following Cadillac Fairview/Greymac/Kilderkin deal; Ontario also has "hardship" provision when revenues don't cover all cash costs -- see Thom (1984, Ch. 9). On the other hand, Massachusetts has no cost pass-through for increases in financing expenses -- see Selesnick (1976).
- Allowed increases based on certain ascriptive characteristics of the tenant, e.g., age. In New York City senior citizens under rent control

(pre-1947) or rent stabilization (after 1971) who would pay more than one-third of their income in rent are exempt from rent increases. The landlord receives a credit against his property taxes -- this shifts the burden to local taxpayers.

- "Fair rent" approach based on the level of rents for comparable units. When a large fraction of the stock is controlled the process becomes circular as the regulator establishes the "going" rent. See, for example, the rent review provisions in the B.C. rent control program; between 1974 and 1982. In Australia rent review is based on comparable rents.

(b) Treatment of the Owner's Investment

Should the owner's rate of return be considered explicitly and how?

- It may not be explicitly dealt with, e.g., in such approaches as:
  - total freeze of the landlord's nominal return;
  - maximum statutory rate of increase (e.g., Ontario 6%; San Francisco 7%; Los Angeles 7%);
  - maximum allowable increase set periodically by the legislature or the regulatory agency (e.g., Santa Monica 7% - 1979, 6.5% - 1980, 5.5% - 1981); and
  - a cost justification or cost pass-through approach where only certain out-of-pocket costs are allowed (e.g., only increases in utility costs can be passed through in San Fransisco).
- We must distinguish among the following:
  - return on capital (owner's equity) and the return of capital, i.e., principal payments on a mortgage (e.g., Ontario's hardship and cost pass-through provisions include the return of borrowed funds);

- treatment of incremental capital expenditures for maintenance or to extend the life of the building. It is critical to determine the allowed return at the margin; and
- maximum allowed rate of return on some measure of the owner's investment (equity).

(c) Treatment of Maintenance Expenditures

Are maintenance expenditures considered in determining the allowable increase in rent? Are there "code compliance" provisions, i.e., regulations requiring the landlord to provide a certain level of maintenance?

- Are there specific requirements to maintain quality from the tenant's perspective and to ensure continuation of amenities (pool, doorman, garage, utilities)? Is the fulfillment of these requirements used as a condition for a rent increase?
- Does the system distinguish between capital expenditures that are mainly the replacement of existing items and expenditures for improvements in the building or specific rental units.
- How are capital improvements handled? What is the rate of write-off? What is the interest rate allowed during amortization? Who exercises discretion (landlord or agency) as to when and how extensive expenditures may be if they are to be passed through to tenants?
- What are the allowable maintenance costs in the determination of rents?
- What is the treatment of the owner's labour/capital in terms of annual maintenance and capital improvements. This is mainly a concern of small landlords.

(d) Frequency of Rent Increases

- annual only for each unit; or

- annual, but in terms of the tenant -- therefore if a tenant leaves the rent of the unit may be increased, hence the landlord receives increases more frequently.

Discussion: "The method utilized to regulate rent adjustments is the most important provision of the rent control statute" (Lett, 1976a, p. 93). There are several basic issues here. The method can be based upon discretion. In this case it will create greater uncertainty and encourage lobbying activity, but discretion will permit an adaptive response to changing economic conditions and to changing priorities.

If the method is based on an objective formula there are two basic alternatives (and mixes of these two) which can be employed: (i) a formula to be applied across the board, or (ii) a formula to be applied individually to each rental unit. Across-the-board rent adjustments are easy to implement and to administer, but in an heterogeneous rental market they inevitably create inequities. If the allowed increases are small relative to increases in demand and landlords' costs, they may lead to undesirable disinvestment, i.e., no new construction, no upgrading of the stock, lower maintenance and repair expenditures, etc. A formula which is applied on a unit-by-unit basis involves very high transaction costs. In large, heterogeneous markets these costs may be prohibitive.

A mix of these two approaches attempts to obtain the advantages of simplicity and low transaction costs for most units, while providing "escape hatches" to landlords who experience financial hardship because of special circumstances. Exceptions on an individual basis are also made to induce landlords to maintain and upgrade the rental housing stock (e.g., by means of cost pass-through provisions). The impact of these provisions would depend on their flexibility, and the degree to which they reflect economic realities and decision making patterns in the rental housing market. For example, a formula may be related to a particular price or cost index to reflect the cyclical nature of the economy. If the index reflects accurately the decision making pattern of the landlord then the impact of the formula would be to reduce risks and maintain stable returns. A fixed annual rate of increase would mean a lower real rate of return during periods of inflation and higher real returns during periods of deflation.

To reduce the potentially confiscatory nature of rent controls and thus reduce incentives for dissaving, many systems make explicit provision for landlords to be allowed a rate of return on their investment. The assessment of what is an appropriate rate of return varies greatly. The provision of a "normal rate of return", that is the rate of return that can be secured on similar alternative investments, minimizes the deviation of rents from their long term equilibrium level. Alternatively, one can adopt the ideological point of view that controls should "squeeze" landlords so that in time the private rental market atrophies and a greater fraction of rental housing is provided directly or is controlled by various public authorities. In other words, the failure to address the owner's return on investment in the formula for determining rent increases may be a deliberate strategy to effectively confiscate part of the property of private landlords. In time, therefore, rental housing markets become dominated by government assistance or the direct provision of housing. This occurred in Great Britain - see page 6-70 below.

(4) Rules Restricting the Removal of Rental Units from the Controlled Stock

These include the following:

- restrictions of various types of the conversion of rental units to other uses;
- demolition restrictions of various types: general versus specific;

- conditional rules for conversion and demolition: the conditions may include appropriation of certain proportions of the land or converted buildings to low-rent units; and
- financial penalties or high transaction costs for conversion or demolition.

Discussion: The purpose of restricting the conversion and demolition of rental units is to preserve the stock of rental housing subject to controls. Since binding rent controls reduce the rate of return landlords expect to receive on their investments, they are likely to search for alternative, more profitable uses of their buildings. Thus, higher rates of conversion and demolition can be expected when stringent rent controls are introduced. To discourage conversion and demolition it is possible to enact an outright prohibition on these activities or to increase the costs of transactions associated with these activities. For example, the City of Toronto has a lengthy and expensive permit application process -- see Chapter 6.

(5) Other Rules

What rules should there be to define and enforce tenants' and landlords' rights? What obligations has each with respect to the other? What rules should govern transactions between landlords and tenants?

(a) Tenant's security of tenure

Here we are referring to statutory provisions governing the non-rent aspects of landlord-tenant relations. These include:

- deposit provisions,
- notice of rent increases or termination of a lease,
- rules for eviction during a lease (damage, noise, failure to pay the rent), and

- rules regarding the renewal of a lease and continuation of tenancy in the absence of a lease (landlord wants premises for own use; renovation; conversion).

(b) Transferability of a tenant's "property right" in a controlled unit

For example, in Hong Kong a tenant can legally sell his right to future occupancy in a controlled unit to his landlord and move out leaving the unit free of controls. In New York, the right to take over a lease when a tenant dies applies to certain relatives, but not to other persons. Even when the value of a sitting tenant's right of occupancy cannot be legally transferred, black or grey markets may exist. For example, Cairo informally tolerates a key-money system (see Malpezzi, 1984a).

Discussion: Some protection of tenants' security of tenure is important to ensure compliance with rent regulation - see Stanbury (1984a, Ch. 4). Without such protection landlords may use their powers to effectively force tenants to surrender the rights given to them by controls. This is especially true if the control system includes provisions for vacancy decontrol because when a tenant leaves the landlord can increase the rent to the market level. Therefore, a system that stipulates just causes for eviction is necessary.

Provisions to regulate relations between landlords and tenants to provide a stable, fair system of interaction are also desirable. These may include limits on deposits (without such limits, deposits may become "key money" payments reflecting the capitalized value of tenants' rights, thus transferring back to the landlord the subsidies controls accrue to the tenant); and provisions for ending or renewing leases. Finally, in some cases the option to contract out of controls or transfer tenant rights may be given. In Chapter 4 we discuss the advantages and disadvantages that such options create.

3.0 ADMINISTRATIVE CHARACTERISTICS

3.1 Broad Choices

One cannot divorce the design of the administration of a system of rent regulation from the choice of substantive rules. For example, a system of rent control which freezes rents as of a specific date and provides for a fixed, allowable rate of increase for all units without provisions for individual adjustments requires fewer resources (including information) for implementation and administration. It ensures relatively low transaction costs and is administratively attractive since it appears to ensure objectivity. However, the "social" costs of such a system will depend on its stringency and may involve inequities in individual cases. Once there is an attempt to deal with individual inequities by means of further development of substantive rules, the program becomes complex, requiring a more refined machinery and involving higher transaction costs. (Justice, too, has a price.) In some sense, a compromise can be sought by ensuring less stringent general controls, with very limited scope for those seeking to remedy an inequity.

Experience suggests that administrative machinery that seeks to obtain precisely calibrated results (i.e., individual adjustments) such as was the case in New York City, eventually breaks down. Simple, across-the-board adjustments are reinstated -- see Sternlieb and Hughes (1976). Thus, the basic design decision that must be made is between simplicity versus stringency. The range of choices is illustrated by the following matrix:

Degree of Control Over Rents

		Moderate/Less Restrictive	Very Stringent
Complexity of the Control System	Simple System	1 can be done	2 lead to break down
	Complex System	3 move from 1	4 necessary evil

Under a very stringent system of controls the gap between R_e and R_c will be large. Given the usual amount of variability in the individual circumstances of landlords, such a system will produce numerous hardship cases and inequities. Some landlords will not be able to cover their cash costs and will have a strong incentive to either cut back new outlays on maintenance and, in time, to "walk away" from their buildings. A very stringent system, therefore, will create a strong demand for exceptions as the rent constraint is tighter for more units. Without a fairly complex system to deal with the exceptions (i.e., hardship cases, anomalies, etc.) controls will produce counter-productive results such as "cheating", abandonment or a severe drop in maintenance by some landlords. Therefore a system that is both very stringent and simple (Box 2) could not remain in effect for long. There would be too many "hard cases" that could not be accommodated by its simple "across-the-board" rules. If demand and/or cost pressures remained, a stringent but simple system would begin to break down as it would generate much counter-productive behavior. Therefore, rent controls that are very stringent require a fairly complex system in order to deal with the hard cases and prevent too many individual inequities (Box 4). It is possible to use simple administrative rules where the restraint on rents is only moderate (Box 1). Moderate restraints produce fewer hard cases and inequities of the sort in which landlords fail to cover their cash costs for example. Such a system can work quite well in the sense that those subject to it will abide by its rules -- particularly if there are periods in which demand/cost pressures abate but the allowed rate of increase remains the same. Then landlords can begin to close the rent gap ($R_e - R_c$).

Box 3, in effect, represents a feasible combination, but it would amount to a "redundant" system of rent controls. There is little need to have a set of complex rules to apply discretion in individual cases where the restraint on rents is moderate rather then highly restrictive. It may well be that a system which starts out as Box 1 will move to Box 3 as landlords and tenants convince the regulators to become "more sophisticated" about rent controls.

3.2 Design Characteristics

As to the design of the administrative machinery one must consider two critical characteristics: (i) the organizational structure of the system of controls, and (ii) the authority and responsibilities of its administrators. The choice of organizational structure may influence the credibility of the system, its orientation (e.g., is it a body representing the different interest groups or an impartial body?), and its costs of operation. The ability of a system to adapt and change as it meets new circumstances in the rental market is rooted in its structure and the scope of its powers, including its discretion. Flexibility and discretion, however, are also sources of uncertainty and will affect the formation of expectations in other areas -- often in unanticipated ways.

Indeed, the designers and administrators of rent control systems devote too little time to understanding how expectations are shaped by the basic structure of their system and by the "signals" embodied in the specific decisions they make. All relevant behaviour occurs in the future (which is not to say that all "history is bunk" to quote Henry Ford). The future, by definition, is uncertain -- hence every decision maker must (implicitly at least) formulate expectations about future states of the world. For example, the absence of controls over new rental units built after controls are imposed may not leave future supply unaffected if, for whatever reason, builders/investors expect that within a few years controls will be extended to new units. (We shall develop the analysis of effects of administrative characteristics upon expectations and uncertainty in Chapter 4.)

The scope of responsibilities and means that the system's administrators have available for educating the public and for providing information determine the degree to which responsibilities for enforcement lie with the public or with the system's administrators. Almost regardless of the size of the enforcement staff, the enforcement of rent controls is effected on a decentralized basis by landlords and tenants themselves. Morever, zealous enforcement is not a necessary condition to achieve compliance by most landlords. The degree of compliance may be lower in the "amateur landlord" sector of the rental market (i.e., landlords with small holdings) where we would expect both landlords and tenants to be less well informed about the control system's rules and to make informal agreements. The costs of organizing are likely to prohibit active tenant organizations in this part of the market. For example, in 1981 one-third of all rental units in Ontario were in buildings of six or fewer units (MOMAH, 1983, p.15). In 1975 21% of low-rise rental buildings (those with 7 or fewer units) in Metro Toronto were owner-occupied and 75% were owned by individuals or by partnerships. These low-rise buildings provided 46% of all rental units in Metro Toronto (Ministry of Treasury, Economics and Intergovernmental Affairs, 1975).

When a system of controls is very stringent, individual adjustments are not usually sufficient to alleviate specific instances of hardship. If stringent controls are enforced to the letter of the law, hard cases -- usually among landlords -- are created. Several counterproductive (and to some, counter-intuitive) things occur. The morale of the entire control system is threatened if the instances of hardship are well publicized. As a result, more participants may be willing to violate the rules to ensure they will not end up as hard cases. Second, efforts to remove controls may be increased -- using up real resources in what may be a futile quest. Third, the regulators may lose their stomach for the job and, in time, controls may break down as they become the rule of men rather than the rule of law.

Where enforcement is "too lax" there is a tendency for the control system to erode. (This is not to say that anything other than perfect fidelity to the controls is evidence of "laxness".) Some rent adjustments are made outside the law and the regulatory system may lose some of its efficacy in the sense of controlling rents. On the other hand, as we argue in Chapter 4, some adjustments that landlords make outside the law are the reason that several stringent systems of rent control have endured so long with only minimal consequences in terms of the distortion of the long-term supply of rental housing. As long as the system responds to tenant complaints and brings about quick corrective action, illegal adjustments that are made by landlords with the tacit agreement of tenants serve as "lubricants" for the system, thereby reducing the incentive for disinvestment by landlords. By obtaining higher rent increases than are legally allowed, the landlord is able to reduce the gap $R_e - R_c$ and thus the incentive to restrict the supply of housing services by reducing maintenance or by making efforts to remove his building from the controlled stock. Such an informal reduction in the stringency of the system makes it more tolerable for landlords. Informal/illegal adjustments are more likely without a rent registry, as is the case in Ontario -- see Thom (1984, Ch. 17).

When the control system does not, or cannot respond quickly to tenant complaints, it will erode and an illegal (black) rental market may evolve. This may occur when funds for enforcement are not sufficient and penalties do not provide sufficient deterrence. (We note that in Ontario the Residential Tenancy Commission came into effect in 1979 but it was not until 1983/84 that it first prosecuted rent control violators.)

A system design characteristic which is often ignored, but is critical for system performance, concerns the choice of mix between active enforcement and passive enforcement (i.e., one that only responds to complaints). Passive enforcement is a means for ensuring the "moderation" of a system which formally is too severe without the political costs that accompany the overt relaxation of controls. The costs of such passivity include (i) discriminatory rent increases for those with less information -- typically the ones for whose benefit controls were initially imposed; (ii) the risk that the system will totally collapse; and (iii) a more general erosion of social norms, such as an increase in the lack of respect for the law.

Therefore, a mix of passive and active (specifically targetted) enforcement policies may provide the benefits of informal adjustments without the severe social costs, and without the prohibitive costs of enforcement. There are, of course, some problems for officials where they knowingly tolerate certain types of evasion of the law up to a point. First, they can be accused of playing symbolic politics -- of introducing and supporting a system of controls which governs rent increases far less than it appears to do so -- see Stanbury and Thain (1986, Ch. 4). Second, someone may "blow the whistle", in the name of equity, on informal (i.e., illegal) adjustments that allow the system to "work" in the sense of reducing its adverse effects on allocative efficiency. There is a trade-off between reducing the distortions to allocative efficiency by means of officials tolerating a limited amount of evasion and the increase in differential discriminatory treatment of landlords and tenants that such activity produces. We now consider the specific alternative attributes of the administrative machinery, its procedures and powers.

3.3 Administrative Provisions in More Detail

(1) Organizational Structure of the Regulatory Agency

The design alternatives appear to be the following:

- a line department of a state or provincial government or a municipality;
- an appointed board under the authority of the government. Are the members to be representative of particular interests or should they be independent public servants?
- an elected board whose global budget is approved by government; and
- an elected board with the authority to "tax" landlords and/or tenants to finance its expenditures.

Discussion: A decision must be taken as to the degree of independence the agency responsible for the administration of rent regulation shall possess. An independent agency may relieve the government from politically undesirable responsibilities and from some immediate pressures by interest groups. Independence also means giving up a certain amount of control over the day-to-day management of an important policy issue. Appointed boards without independent financial resources are a means for some separation of the rent control system from the daily operations of government.

Where an appointed board is used members may be appointed on the basis of professional qualifications, thus ensuring a measure of independence and objectivity. An alternative to objectivity rooted in professionalization is objectivity that is obtained by balanced representation of the opposing interests, namely landlords and tenants. The problem of having interest group representatives on a regulatory body is the difficulty that such boards have in reaching decisions or in the "political" nature of critical decisions.

Alternatives to these approaches (e.g., patronage appointments) are less desirable from the perspective of rent control objectives, but may be popular with governments for other reasons.

Elected boards tend to represent well the majority interest and may therefore be unsuitable when a balance is sought between interest groups. Elected boards may be influenced to some degree if their financial resources depend directly on the government.

(2) Scope of Responsibilities of the Regulatory Agency

The legislative mandate of the agency responsible for administering the rent control regime may include several different functions such as:

- adjudication (including appeals);
- enforcement;
- mediation, conciliation, and even private arbitration;
- research; and
- administration of non-control policies, e.g., distribution of subsidies.

The agency may or may not have authority to enact its own subordinate regulations (with the force of law) on substantive and/or procedural matters.

Discussion: The scope of responsibilities and authority of the regulatory agency should be a function of the objectives of the system of controls, their expected duration, and the nature of the specific substantive rules which were adopted by the legislature. Where the agency has a high degree of discretion and controls are expected to be of long duration, it will find a research capability very helpful, although the research function can be contracted out.

It will also, in effect, take on policy-making powers as it exercises its discretion over many individual cases. Where rent adjustments are based on individual units, the agency will require extensive resources for its adjudication function.

Depending on the powers with which the agency is endowed and the specific penalties in the legislation, an agency may leave enforcement to private actions through the courts or it can actively identify and prosecute offenders. We note that for constitutional reasons, in Canada a province can't appoint judges nor a regulatory board with the power that judges exercised in 1867. This limits a province's options when it comes to enforcement activities associated with a system of rent control. See MacDonald (1984).

Alternatively, the regulatory agency can internalize some enforcement capabilities. For example, they can issue orders which when filed with the courts have the force of court orders (see Thom 1984, Ch. 13). Since enforcement through the courts is typically expensive it is desirable to provide some enforcement duties and powers to the regulatory agency. An important function often associated with enforcement responsibilities is a requirement to publicly register information critical to private enforcement of controls (e.g., rent levels).

Mediation can be an important function which is designed to substitute for the formal, expensive adjudication process. Mediation reduces interest group conflict in the system in a way that encourages the development of good will. In the long run such activities not only reduce transaction costs, but also may prevent subsequent conflicts. We note, however, that Commissioner Thom (1984, p. 196) recommended that applications under Part XI of the 1979 Act (rent review) not be required to be mediated before they are heard by the Residential Tenancy Commission in Ontario. He noted that the tenants' advocate expressed unqualified opposition to mediation because (i) tenants don't have the resources to match landlords in a mediation encounter, and (ii) mediation unavoidably brings other matters into consideration even though the only point of issue is whether the proposed rent increase is legal (Thom, 1984, p. 195). The Commissioner stated (p. 194) that "the concept of settling rent matters by agreement is contrary to the scheme and operation of rent review". We note that in Quebec, exactly the opposite premise appears to govern the design of the law and procedures. See Stratford (1982) and (1985).

Another function which affects both enforcement and the psychological climate of the control regime is the education of the public through the dissemination of information about the details of controls and how they function.

(3) Adjudicatory Characteristics

The regulatory agency's adjudicatory characteristics include the following:

- the amount of discretion given to the agency in making decisions on individual cases;
- the role of precedent versus pure "ad hocery";
- the onus of proof (landlord or tenant) - it may vary depending on the particular issue;
- lags: the speed of handling cases (are there formally stipulated requirements for processing time?);
- retroactivity of awards;
- requirement to give reasons for decisions;
- formality/informality of proceedings; and
- procedural requirements, e.g., equal protection, due process provisions.

Discussion: There are three basic strategies in the design of the adjudication process: (i) complete specification, i.e., a formally legislated, detailed body of rules and regulations, (ii) evolution of a formal body of rules based on experience; and (iii) maintenance of complete flexibility and discretion to deal with issues as they arise. The first strategy of design requires the development of detailed rules and procedures which seek to cover all possible contingencies. Clearly this is an impossible task. The alternative, therefore, is to provide the administrative agency with some rule-making powers and to let some of the criteria and rules evolve through precedents established by prior decisions. This would appear to require the publication of all judgments and the articulation of rules as precedents are created. That is, reasons must be given for decisions in specific cases and they must appeal to some underlying general principles. The third strategy, the maintenance of complete flexibility, may lead to inequity and thus to a loss of the system's integrity. On the other hand, formal proceedings with strict adherence to complex procedural requirements may increase significantly the transaction costs borne by all parties.

(4) Information Requirements

The regulatory agency may require

- filing information on rents for individual units in a central rent registry;
- landlords to disclose certain information to existing and new tenants, e.g., previous rent level; and
- public disclosure of a landlord's data during applications for rent increases

Discussion: The existence of a central rent registry is a key to strict rent control enforcement. See Thom (1984, Ch. 17) and the study by Slack and Glied (1983). Without a registry, in effect, controls become vested in the sitting tenant and not the dwelling. Without a registry, when a vacancy occurs, the possibilities of enforcement diminish significantly.

An important factor which must be considered in specifying information requirements is the asymmetry with respect to information costs between landlords and tenants. Chapter 4 explores the specific implications of this asymmetry.

(5) Bases of Initiation of Action by the Regulator

Adjudicatory action by the regulatory agency may be initiated:

- on the basis of a complaint, usually by tenants who initiate action by the regulator after some action by a landlord;
- simply by a filing by the landlord, i.e., data for central rent registry;
- merely by notification -- the regulatory agency may require investigation and possibly hearing -- for example, application by a landlord for an increase based on cost pass-through provisions;
- where agency approval is required after an internal analysis, or a public hearing.

Discussion: The role of tenants and landlords in the process has an important effect on compliance and transaction costs. The minimalist position would assume that regulations are complied with unless a complaint is filed. This approach is appropriate for a system of rent controls that is not stringent and thus enforcement is not a critical problem. The requirement for notification provides the agency with a data base for monitoring the behaviour of actors subject to controls.

A system that requires prior approval subject to internal analysis or public hearing typically involves high transaction costs.

(6) Appeal Provisions

- To whom can a landlord or tenant appeal -- specialized tribunal; courts; or to the cabinet?
- What are the grounds for appeal: interpretation of the law; natural justice; etc?

- How long does it take to go through the appeal process?
- Are decisions retroactive?

Discussion: Most rent control regimes have an appeal process. Appeal processes are typically expensive, but reduce uncertainty and arbitrariness. The mere existence of the right of appeal may improve the regulator's decision making in the first instance. It also has considerable symbolic importance.

(7) Enforcement:

- What is the nature and definition of the offences or violations of the regulations?
- What penalties are attached to the violations?
- What is the intensity of enforcement effort (resources and personnel)?
- Are there private law remedies in addition to those administered by the regulatory agency?

Discussion: We have identified the two basic enforcement strategies: an active enforcement strategy, or a complaint-triggered, reactive or passive system. A passive system must ensure special protection of groups in society who are less well informed and have less ability to protect their rights. To achieve effective enforcement a passive approach must be combined with a program of public education.

Our discussion so far has dealt with the intuitive bases for choosing a particular alternative form of a design characteristic. This is the preliminary step for generating alternative designs for evaluation. The second phase must consider each possible vector of characteristics in terms of its contribution to the goals of the system of rent regulation. Therefore, we require a framework which relates effects of alternative design characteristics to a system's effects. In Chapter 4 the theoretical machinery to predict effects given a particular vector of characteristics will be developed, thus completing the theoretical discussion of our analytic framework. However, in Chapter 3 we must first categorize the possible effects that could be produced by a system of rent regulation.

Chapter 3

CLASSIFYING THE EFFECTS OF RENT REGULATION

1.0 INTRODUCTION

The purpose of this chapter is to offer a simple, but robust framework for classifying and analyzing the various effects of systems of rent regulation. Within the framework we seek to include, in principle, all of the possible effects of rent controls. We will also identify (in Section 6.0) the most important effects as they relate to the perspectives of the three important actors in the system: landlords, tenants and politicians. We shall try to draw clear distinctions between the effects of controls on the existing stock of rental housing (which can be likened to a lump sum tax on owners) and the effects on the future stock, i.e., additions to and replacement of the rental stock (see Section 3.0). We shall also distinguish effects in terms of both the number of rental units and their quality, a complex phenomenon involving size, location, related services and upkeep. With respect to existing units we will discuss the complexities of the effects of controls on maintenance, e.g., capital improvements versus operating outlays; discretionary outlays versus expenditures to maintain compliance with legal requirements; and cosmetic versus structural maintenance expenditures.

We shall begin in Section 2.0 with a simple formulation of the central issues. Then we will move to a more extensive consideration of these and other issues. Section 3.0 deals with allocative effects. Section 4.0 deals with distributional effects and Section 5.0 discusses secondary and indirect effects.

2.0 OVERVIEW

2.1 Key Effects

While a large number of effects or consequences have been attributed to the existence of rent controls, both theoretical and empirical analyses have most closely focused on a handful of effects. Consider the following two examples.

Selesnick (1976), in his study of Massachusetts' experience with rent controls prepared for a legislative committee, concentrated on the question of whether there was a continuing shortage of decent, affordable housing for residents of the state. He sought to determine "(i) the magnitude, extent and geographic distribution of the rental housing shortage in the state, and (ii) the types of people (poor, elderly, minorities, working class, etc.) who are suffering from the shortage" (p. xvi). His analysis of the availability of rental housing focused on the following key indicators:

- rent increases (relative to changes in incomes);
- rent-to-income ratios;
- vacancy rates; and
- the extent of substandard housing.

In addition, Selesnick provided data on changes in the cost of living, property taxes, the volume of new construction, the maintenance of rental properties, and rent control administrative costs, time lag for decisions and the volume of evictions (Selesnick, 1976, pp. xix - xxii).

Rydell *et al.* (1981, p. 48), in their study of the impact of rent control in Los Angeles, identified three "primary impacts:

- rent reductions,
- housing deterioration caused by rent reductions, and
- rental housing losses caused by rent reductions."

The last item includes demolitions, and tenure conversions which remove rental units from the controlled stock. Rydell et al. (!981, p. 69) identified three possible secondary effects of rent control:

- reduction in property tax revenue,
- changes in demand for city services, and
- changes in energy consumption.*

The reduction in property tax revenue refers to the fact that controls result in a deterioration of the stock and that is associated with a decline in the average income of tenant households. Rydell et al. (1981, p. 76) state, "housing economists are in general agreement that ... a decline in housing quality would be associated with ... a decline in the income of occupants [that] the rent-controlled stock would attract". This decline in income changes the demand for city services. For example, demands for police and fire protection are likely to increase while the demand for parks is likely to decrease. They also note that deterioration and declines in the housing stock could well reduce local government's revenues and increase expenditures, but they expected the effects to be small in the case of Los Angeles.

We suggest that the "key effects" of rent controls are the following:

1. Rents - while the level of rents is of concern, once controls are in place the focus is primarily on the rate of increase of rents in the controlled sector (R_c) as compared with the CPI, household incomes and rents in the uncontrolled sector (R_u). From the point of view of allocative efficiency the most important matter is the gap between controlled rents (R_c) and their equilibrium level (R_e).

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* The authors suggest that rent control reduces residential mobility. Hence, some households "may cancel moves that would otherwise bring them closer to their workplace. If this occurs, gasoline consumption will rise" (Rydell et al., 1981, p. 77). They also suggest that "undermaintenance by landlords may bring about less-efficient use of heating fuels in rent controlled housing".

2. Price of controlled rental buildings -- which, in efficient capital markets, represents the capitalization of the anticipated lower net income and future disposal value of the property usually associated with rent controls.

3. Supply of rental services from existing units -- both the number of units and quality of rental services can be reduced by conversion, demolitions and reconversion, and by reductions in the level of maintenance.

4. Supply of new rental units -- may be reduced even if new units are exempt from controls, ceteris paribus. To increase supply it may be necessary to offer tax expenditures or direct cash subsidies from government.

5. Mobility effects -- it is usually suggested that rent controls will reduce mobility or turnover of tenants within the rental stock, and reduce geographic mobility. Therefore, the efficient allocation of labour may be impaired.

6. Government revenues and expenditures: the tax base of local governments may be reduced by declines in the market value of rental properties due to rent controls thus increasing the tax burden on other types of property, e.g., ownership of homes, commercial and industrial. (We note that in Ontario local property taxes are not based on market value assessment. In fact, the assessment roles have been frozen since the early 1970s - except for small adjustments within classes of property. For this reason, rent control in Ontario will not reduce tax revenues.) Moreover, rent controls may result in lower income tax revenues as the income of landlord's fall and as they incur capital losses. On the other side of the fiscal process we note that if the supply of rental housing is reduced, there may be pressure for government subsidies, public housing and various tax incentives. See Ontario Ministry of Housing (1985a).

7. Administrative costs -- rent controls require a regulatory body to implement them. This entails government (taxpayer) outlays and costs for

tenants and landlords who use up resources in appearing before the regulatory body.

This list ignores the distributional consequences of rent controls. This is equivalent to thinking about Hamlet without the Prince of Denmark. Indeed, rent controls are usually imposed with the objective of redistributing income from landlords to tenants or to prevent a redistribution from tenants in the face of excess demand for rental housing when rents are beginning to rise rapidly. But the distributional consequences of rent controls are far more complex than this statement implies. For example, we need to ascertain the effects of controls on sitting tenants versus new or prospective tenants and among tenants of various income levels. It has often been pointed out that more middle-income tenants benefit from controls than do lower-income tenant households. Presumably we also wish to know how controls affect landlords, for example, existing versus new landlords, and landlords with small holdings versus corporate, large-scale landlords. These are only some of the distributional issues that are raised by rent controls. A more extensive discussion is found in section 4 below.

2.2 Analytical Dimensions

A complete analysis of the effects of a system of rent controls should address the following analytical dimensions:

(1) The Type of Effect: We should distinguish between economic effects and psychological dimensions such as respect for the law that may be influenced by a rent control system that is subject to "black" or "grey" markets in which some landlords and tenants "contract out" of the control regime. The economic effects will include the allocative effects (price and output) including the welfare losses associated with unsatisfied demand in terms of consumers' surplus foregone. Economic effects will also include changes in the distribution of income, wealth and consumption opportunities.

(2) Direction and Magnitude of Effects: A useful policy analysis requires that we ascertain reasonably accurately the magnitude as well as the direction of the effects of rent controls. For example, suppose a particular system of controls has a very substantial adverse effect on the future supply of rental units but is only able to hold R_c below R_e by only five percent in the short run; policy makers may feel the game is not worth the candle. In many instances, the debate over controls revolves around the magnitude of their effects. For example, the proponents of moderate (or second generation) rent controls [e.g., Gilderbloom, 1983c; Baar, 1977; Appelbaum & Gilderbloom, 1984] argue that such controls have little or no adverse impact on the supply of housing services from the existing stock (through demolitions, conversions and under-maintenance) and on the supply of new rental units. Yet moderate controls, they assert, have the benefit of preventing very sharp increases in rent during (fairly lengthy) periods of excess demand. Other observers, e.g., Smith and Tomlinson (1981), hold that the adverse consequences of controls outweigh such benefits.

(3) Timing of Effects: Timing in the matter of rent controls is of the essence. Human beings almost always prefer to accelerate the receipt of benefits and to postpone costs. Rent control is a policy in which politicians can confer immediate benefits on a large number of people (there were some 950,000 tenant households in Ontario in 1975 when controls were imposed) at the expense of a relatively few landlords (perhaps 300,000). The adverse consequences, however, are usually delayed for some time -- perhaps even years. These consequences such as reduced new construction (hence employment), higher search costs, lower vacancy rates, lower tenant mobility, and reduced maintenance of rent-controlled buildings, when they do appear several years later may not even be connected to the imposition of rent controls (see Kochanski, 1980).

The analysis of the effects of controls should distinguish between immediate effects (those that occur almost instantly in response to the imposition of controls or in response to changes in the control regime); short run effects (those that occur during the period it takes to build new units or to convert existing rental units to other uses -- in real time this may be several years); and long-run effects (those that occur in the fullness of time when it is possible to build new units, convert existing ones and effect all other possible changes -- in real time this may take several years or even up to a decade.

The desire to alter the timing of increases in rents in response to changing macro-economic conditions and to changes in rental housing markets may be the most important factor explaining political demands for rent controls. The imposition of controls is almost always associated with rapid increases in rents relative to previous rates of increase in rents and recent rates of increase in incomes, and consumer prices generally - see Stanbury (1984a). Often the sharp increases in rents follow a period where rents in real terms declined and/or the ratio of rent to income declined on average. The issue, therefore, is the timing of increases in that people desire both time to adjust to new realities and they want the transition to be smooth rather than discontinuous. They prefer rents to rise, for example, by 8% annually for five years in a row rather than increase by 35 or 40% two years from now and then remain constant for the next three years. Perhaps the strongest argument for rent controls is as a "blow-out preventer", i.e., to curb very rapid increases in rent in the face of short-run excess demand. The object is not to hold rents below their market-clearing level in the long run. It is to prevent increases of much more than the rate of increase in inflation or average household incomes -- see Chapter 7.

(4) Identifiability of Effects: It may be difficult or impossible to identify all of the effects of rent controls, particularly when they occur some years after controls are imposed. We note that renters may look at the effect of controls in the short run and measure the benefit for them (reduction of rents) by comparing rent levels in the controlled and uncontrolled sectors. There may be inadequate adjustment for quality differences, and there may be insufficient recognition that the equilibrium probably lies between the rent levels in the controlled and uncontrolled sectors. In other words, people may just think how much more rent could my landlord get for this unit, from me or someone else, if he was free to charge whatever he pleased. Hence the tenant's view may ignore market effects generally. The theories of market processes don't say that individuals understand elasticity effects. Adjustments take place as a result of the "invisible hand", not knowledge. Similarly, if quality deterioration is related to aging of buildings it may not be considered an effect, or it may be labelled as an effect of landlord greed rather than rent control. The measurability of effects may affect the popularity of controls. Not only might they imply that people underestimate the costs, but they may overestimate the benefits, which could lead to the problem that the existence of controls itself stimulates the demand for controls.

(5) Pecuniary Effects Versus Real Effects: The analysis of the effects of controls should distinguish changes in the financial (or pecuniary) position of the various participants in the system from the real effects in terms of output or real prices. For example, the imposition of controls could well result in a sharp decline in the market value of rental buildings in the controlled sector - see Chapter 6 regarding the evidence in Ontario. Hence the wealth of these landlords will be reduced. While this pecuniary effect is highly significant for such landlords, at that moment there has been no real effect in

terms of the quantity or quality of rental housing available to tenants. However, in the longer term if the supply of housing services from the existing stock is reduced and if the supply of new units is reduced by the threat of controls in the future, the pecuniary position of sitting tenants will be unchanged by these real effects on the supply of rental housing services. In other words, total economic welfare will be reduced although the financial position of sitting tenants will be unchanged. Note that the real welfare of sitting tenants will also be reduced to the extent that landlords are able to reduce the quantity of housing services supplied by reducing the level of maintenance, for example - see Chapter 4.

(6) Anticipated Versus Actual Effects: We should try to distinguish between anticipated (*ex ante*) and actual (*ex post*) effects of a system of rent regulation. Even in a world of rational expectations [see *The Economist*, October 20, 1984, pp. 64 - 65] there may be a substantial deviation between anticipated and actual effects, particularly for individual actors. People "guess wrong" about the future. Exogenous events occur to prove Burns' point that "the best laid plans of mice and men gang aft a glee". In recent years the macro-economic environment has become more turbulent and thus harder to predict, e.g., events in the U.S. can have a significant impact on Canadian interest rates which, in turn, greatly affect the demand for new construction.

(7) Partial Versus General Equilibrium Effects: A market economy is an interdependent system. Changes in one area "ripple out" and cause changes in others. A proper analysis of the effects of rent controls should take into account not only changes in the rental housing market, but also those in related markets, e.g., the ownership housing market, and in the construction industry. If rent controls reduce the future supply of rental units and this stimulates -- through use of the political system -- an increase in financial assistance for

new constructon, the effects of controls will spread far beyond the domain of the rental market. If total future housing supply is reduced by rent controls construction employment will be reduced. Because new construction appears to have a larger multiplier effect than some other types of economic activity, the general level of unemployment may increase.

2.3 Three Broad Categories of Effects

In the remainder of this chapter we group the various effects of rent controls into three broad categories. The first is allocative effects which focus on the changes in prices and quantities in the rental housing market. Do rent controls hold rents below the market-clearing level? By how much? What effects do controls have on the existing stock of rental units? Can the supply of services shrink even though the number of dwelling units is held constant by bans on conversion and demolition? Do rent controls reduce the future supply of rental housing by reducing the incentive to invest in new buildings? These are some of the possible allocative effects of rent controls.

The second category of effects is concerned with the impact of controls on the distribution of income, wealth and consumption opportunities. Who wins and loses as a result of rent controls? Is it true that controls effect a redistribution to low-income housholds from high income ones? Do sitting tenants benefit, but new entrants lose as a result of controls? Do homeowners win or lose? Do all landlords lose or just those unfortunate enough to be holding rental properties when controls are originally imposed? If government assistance to the rental housing market increases as a result of controls, who bears the burden? If maintenance declines under controls, are sitting tenants necessarily better off? Ideally, a careful analysis of the distributive impact of controls should be able to answer these and related questions.

Finally, the third (and largest) category incorporates the secondary and indirect effects of rent controls. Here we include effects on government revenues, expenditures and regulation, non-price rationing activities, psychological effects, and other effects. We note that if government revenues are affected there is a question whether this is an indirect effect of rent controls (i.e., reduced revenues) or a distributional effect. It will be a distributional effect if the tax burden gets adjusted, while total government revenues stay the same. We would expect the latter to be the case in Ontario, since municipalities tend to operate by determining their budget then dividing the total necessary revenues by the assessment base to get the mill rate. While the mill rate implications may affect the budget setting process, the effects of rent review will probably be too small to influence the total budget decision.

3.0 ALLOCATIVE EFFECTS

3.1 Price Effects

The primary potential effects of a system of rent controls include the following:

- rents in the controlled sector: level, rate of change, and pattern, i.e., price discrimination (quality held constant);
- rents in the uncontrolled sector: level, rate of change, and pattern (quality held constant);
- the price of rental buildings subject to controls, i.e., capital values -- level and rate of change (this translates directly into changes in the landlord's rate of return);
- impact on the discount rate used to compute the present value of revenues and expenses of existing and proposed rental buildings;
- price of houses, condominiums, and co-operatives in the ownership market;

- pressure to reduce the costs of supplying rental services, while holding quality and quantity constant; and
- administrative costs to landlords, tenants and taxpayers.

3.2 Discussion

Presumably the core of rent control as a policy issue is the extent to which controls reduce rents in the controlled sector below what they would be otherwise. For the most part we would expect tenants to focus on the rate of increase in rents in the controlled sector as compared with what they would be in the absence of controls in the short run. We would also expect tenants to be concerned with the year-by-year increase in rents relative to increases in their income and to increases in prices generally (e.g., the Consumer Price Index).

While a reduction in the average rate of increase in rents (say from 8% or 9% to 4% or 5%) is attractive to tenants, they are also concerned with the variance about the mean. In particular, if a small fraction of tenants experience large rates of increase their complaints could move politicians to focus on the exceptions rather than the rule. Some idea of the variance in rent increases occurring in 1975 when agitation for controls was at its peak in Ontario is given by the Ministry of Consumer and Commercial Relations (1978, p. 14). They cite a survey conducted by the Ministry of Municipal Affairs and Housing, indicating that in Metro Toronto rents increased an average of 11.7% in 1975 over 1974. However, 3.4% of tenants experienced increases of over 30%. If the sample is accurate, then some 4000 households in Metro Toronto and about 10,000 through Ontario had to cope with rent increases 2.5 times the average in the province. Moreover, a rent increase of 30% was almost three times the increase in the CPI of 10.8% in 1975 and 10.9% in 1974. If politics is the business of "squawk minimization", then a small group with a direct and intense interest in an issue can succeed in obtaining political action to deal with such "outlying" cases.

The impact of rent controls on allocative efficiency is heavily dependent upon the size of the "rent gap", i.e., the difference between rents in the controlled sector (R_c) and what they would be in equilibrium in the absence of controls (R_e). Fallis and Smith (1984a, 1984b) argue that any system of rent controls with exemptions creates two distinct markets for rental dwellings: the controlled sector where rents (R_c) are held down below both the level of rents in the other market, the uncontrolled sector (R_u), and the market-clearing equilibrium level of rents (R_e) that would occur in the absence of controls. They argue that $R_u > R_e > R_c$. See also Marks (1984b) and Econanalysis Analysis in MOMAH (1982). In Chapter 4 we will argue that in a dynamic framework and where the usual optimizing assumptions are changed the usual relationships posited by strict economic theory may not apply.

In any event, the idea that binding rent controls creates two distinct but "homogenous" markets can be strongly questioned. In particular, we suggest that while the nominal labels apply, the critical question for allocative efficiency is the relationship between R_c and R_e. Specifically, within the controlled sector some landlords "may be more controlled than others".* That is, some may be able to set their rent closer to R_e (particularly over time) than others are able to do so for a variety of reasons. These may include the following:

- The willingness and ability of the landlord to exploit the minute details of the control regime to increase rents. In the case of Ontario, we note that a much higher fraction of landlords owning buildings with more than six units apply for higher increases than do the owners of smaller buildings.
- The willingness of the landlord to violate the regulations and set his rent above the legal level. The success of the landlord in doing this will

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* We are indebted to John Todd for emphasizing this point and its implications.

depend upon the complicity or ignorance of tenants and the intensity of enforcement effort by the rent control authorities. We note that in the absence of a rent registry it is easier for landlords to increase rents to new tenants -- see Thom (1984, Ch. 17).

- The vigilance of tenant groups in the landlord's buildings -- in the most extreme case, a zealous tenant group may ensure that not only does no "cheating" occur, but also that the landlord is discouraged from obtaining the full benefit of the detailed regulations, such as may be provided on a cost pass-through basis. Where people are organized and are used to dealing with regulations, they are more likely to be able to see that landlords abide by the rules. (See the discussion in Chapter 5 re Table 5-5).

As long as there is not perfect fidelity to controls, therefore, the *actual* rent level in the controlled sector (R_c^*) may be *above* or *below* the theoretical legal level of rent (R_c) for a specific unit. We note in the case of Ontario that the legal annual rate of increase in R_c may be greater than the statutory rate of 6% due to legitimate use of the cost pass-through system. For example, in 1983/84 the Residential Tenancy Commission granted an average increase of 10.6% (versus 19.7% requested) on 106,472 rental units. However, 6.3% of these units received an increase of more than 20% while 13.0% of these units received an increase of *less* than 6% (*Annual Report*, 1983/84, pp. 37, 40).

We note also that the legal rate of increase for a unit (building in Ontario) may have the effect of opening or closing the gap between R_e and R_c depending upon such demand factors as household formation, increases in income and increases in the price of substitutes, and such supply factors as increases in the landlord's costs and the volume of new rental units coming onto the market.

The key idea, however, is that the gap, $R_e - R_c$, at any point in time is not the same for all units or buildings (holding considerations of quality constant). In other words there is a distribution of R_c^* (the actual rent level) about R_c with most of the distribution lying to the right of R_c. Therefore, there is a distribution of $R_e - R_c^*$ rather than two points such that $R_e > R_c = R_c^*$. The shape of the distribution of the gap (Re - R*) will also vary over time in response to such variables as

- the intensity of enforcement of the control regulations by the regulator and/or tenant;
- attitudes of landlords toward controls (willingness to "work the system") and their willingness to violate the regulations; and
- basic supply and demand conditions.

This insight suggests that for allocative efficiency the critical design characteristic of a rent control system is the size of the gap, $R_e - R_c^*$. Hence it might be argued that detailed rules are important as they affect:

(i) the level of R_c, the legal allowable level of rent for a controlled unit including the statutory level and any applicable cost pass-through; and

(ii) the distribution of controlled units above (or below) R_c which measures the ability of landlords to "escape" from the most stringent application of controls. In this context "escaping" means that the landlord is able to reduce the gap between the actual rent level and the (long run) equilibrium level.

In general terms, it seems reasonable to argue that economic effects of a system of control in terms of allocative efficiency are related to the magnitude of the gap ($R_e - R_c^*$). We expect that small deviations between R_e and R_c^* are far less significant than are large ones.

The gap between controlled and equilibrium level of rents has to be considered in several dimensions:

- the immediate gap;
- the long term gap based on experience and expectations; and
- special features of the controls which create specific incentives having the effect of moving actual controlled rents toward R_e. Many of the design characteristics implicitly focus on how many units in the controlled sector may move closer to R_e.

Therefore, one might classify rent control schemes as follows:

- a system in which controls are purely symbolic and actual rents are those that would occur in the absence of controls; (see Stanbury and Thain, 1984, Ch. 4);
- a system of perfectly tight controls where $R_c^* = R_c$, i.e., landlords are not able to close the gap by "cheating" or cleverly exploiting the detailed regulations; and
- a system of controls with some flexibility and some cheating such that R_c^* greater than R_c, but R_c^* is less than R_e, i.e., actual rents for most units are still below the market-clearing equilibrium, but they are above the level if there was perfect fidelity to the control regime.

One implication of the "gap approach" is that the landlord's key argument against controls, namely that when rents are held below equilibrium levels the rental market is "destroyed" in the sense of totally discouraging new supply, is far too simple. The supply effects, in reality, are more complex. Because most control systems are not perfecly tight, there is a distribution of the gap $R_e - R_c^*$. Therefore, not all landlords suffer equally. Indeed, some may be able to set their rents at the equilibrium level. However, the long term effects on supply also depend upon expectations - see Chapter 4. The existence of controls, even "flexible" controls, may well be viewed as the harbinger of worse things to come.

We note that if capital markets are efficient the effect of the rent gap ($R_e - R_c^*$) and any changes in the residual value of the building will be immediately reflected (capitalized) in the *market* value of rental buildings in the controlled sector. In other words, the present value of the effects of controls on net rental income and on the building's residual value will be evident immediately. Faced with immediate capital losses, existing landlords may decide to hold on to their buildings hoping that in time with inflation they will be able to recover the nominal value of their investment. Even if they are able to do this in a decade or so, they will have suffered an opportunity cost in terms of the foregone return on their capital. We note, however, that capital markets may not function perfectly and there may be substantial differences in the observed transaction prices of rental buildings after controls have been imposed when all the relevant factors have been accounted for. The Commission of Inquiry into Residential Tenancies received testimony from landlords to the effect that lenders focus almost exclusively on the flow of net income rental buildings produce and ignore their residual value. Perhaps the capital market has not fully come to grips with rent control. If this is the case, the cost of supplying rental housing is increased.

Moreover, as we suggest above, the imposition of controls may, *ceteris paribus*, alter the discount rate applied to subsequent investments in both existing rent-controlled buildings and to new, uncontrolled rental buildings. With respect to the former, there would appear to be two offsetting tendencies. Controls may reduce the variation in annual net cash flows, for example, by reducing vacancy rates and by changing the expectations of both landlords and tenants. Therefore the appropriate discount rate would fall. On the other hand, controls may increase the perceived riskiness of owning rental buildings if, for example, the estimated allowable rate of increase in rents is not systematically related to increases in the landlord's costs or because it is believed that there will be "chaotic" changes in the control regime in response to swings in political pressure. If this is the case, the discount rate would increase. If, on balance, the discount rate applied by investors or potential investors in rental buildings rises, the greater will be the decline in the market value of the controlled stock following the enactment of rent controls.

With respect to the price of rental buildings and the landlord's rate of return we note that in the purest sense, since the market value of the building should equal the capitalized value of future returns, the rate of return on current market value should be unaffected by controls.* Using the precontrols value of the building, the rate of return and price should be affected equally by controls. Of course, depending upon the rules for price adjustment, changes in the inflation rate and other factors may effect the rate of return on historical cost and market price differently. The only other source of a differential effect is the impact on the discount rate which we have noted.

Even if newly-constructed rental buildings are exempt from controls, investors may have reason to believe that controls will be extended to such buildings in the future. This incremental risk will be reflected in the discount rate (required rate of return) applied to new rental projects. On the other hand, the bifurcation of the rental housing market created by a control system with exemptions, where there is also a low vacancy rate, will generate "spill-over" demand for uncontrolled rental units. As a result -- as Marks (1984b) and Fallis and Smith (1984b) show -- R_u will be above both R_c and R_e. Hence rents in the uncontrolled sector will be boosted by controls, ceteris paribus. This will increase the net returns on investments in new rental housing. However, a large rent-controlled sector where rents are substantially below those in the uncontrolled sector will make it harder for landlords in the latter to obtain much higher rents. They may obtain them but suffer higher turnover as tenants succeed in their search for a cheaper rent-controlled unit.

The effects of rent control on the price of ownership housing are hard to determine, a priori. If controls reduce rents in a large controlled sector substantially and the savings are banked, tenants may be able to enter the ownership market sooner or to make larger down payments or acquire more expensive houses or condominiums. On the other hand, controls may increase the gap between the monthly cost of rental housing and ownership housing and thereby make tenants less willing to change tenure and use a higher fraction of their income on housing services. If inflation is significant in the ownership market, however, renters will be foregoing substantial capital gains. Therefore, it is not clear whether rent controls will, on balance, increase or decrease the price of ownership housing.

Depending on the design of the cost pass-through provisions and their utilization controls may create incentives for landlords to become more efficient in supplying rental services. (It has been argued that cost pass-through provisions reduces the landlord's incentive for efficiency so long as the current rent is below the equilibrium level.) While such X - inefficiency could not exist if the rental housing market is highly competitive, this may not always be the case. In addition, rent controls will impose an administrative burden on both landlords and tenants who choose to (or have to) appear before the regulatory body. Perhaps that is why the great majority of landlords in Ontario simply took the "automatic" 6% annual increase even when their costs appeared to be rising much more rapidly. For example in 1980, 1981 and 1982 the

CPI increased by 10.2%, 12.5% and 10.8% respectively (Thom, 1984, p. 52) while the statutory increase was 6%. Yet the Residential Tenancy Commission's 1981-82 Annual Report (p. 50) indicates that there were only 2170 applications by landlords for rent review in 1980/81 and 5027 in 1981/82. In 1981/82 there were 2782 hearings involving a whole building review. The number of rental units affected was 82,650 (pp. 27, 29). Since there were about 839,000 tenant households in Ontario in 1981 subject to controls (Pringle, 1985, Figure 4.1), less than 10% of tenants were subject to applications by landlords to obtain rent increases more than the statutory 6%. (More generally, see Chapter 5.) However, this does not take into account illegal rent increases, the extent of which is not known.

3.3 Quantity or Supply Effects

The primary quantity effects of rent controls fall into two categories: those that affect the supply of housing services produced from the stock of rental housing at the time controls are imposed (the existing stock), and the change in the quantity of housing services produced by new rental buildings. With respect to the latter, we want to know if rent control alters the shape and position of the supply curve for rental units built after controls are imposed.

Before we examine quantity or supply effects in more detail it is necessary to draw a number of important distinctions associated with the phrase "the supply of rental housing". First, supply can refer to the number of separate, self-contained rental dwellings or "units". For example, an apartment building may have 26 suites in it. This figure, however, says nothing about the size or quality of the units. The building may consist of 26 bachelor units each having 500 square feet, or it may consist of the same number of 3-bedroom suites each about 1500 square feet in size. The number of units, therefore, provides little guide to the number of persons who could be accommodated in the same dwellings without overcrowding.

Second, while bushels of No. 1 Northern Hard Wheat are homogeneous, rental dwelling units are not. Rental units not only vary by size but also by other dimensions of "quality", e.g., the number of bathrooms, the newness of appliances, whether or not there is a view, the cleanliness of the building, the adequacy of soundproofing, and the reliability of the heating, plumbing and elevator systems. (We note that Social Policy Research Associates in their study for MOMAH -- see Blatt (1982a) used scores of detailed attributes just to measure the quality level of maintenance. See Chapter 6.)

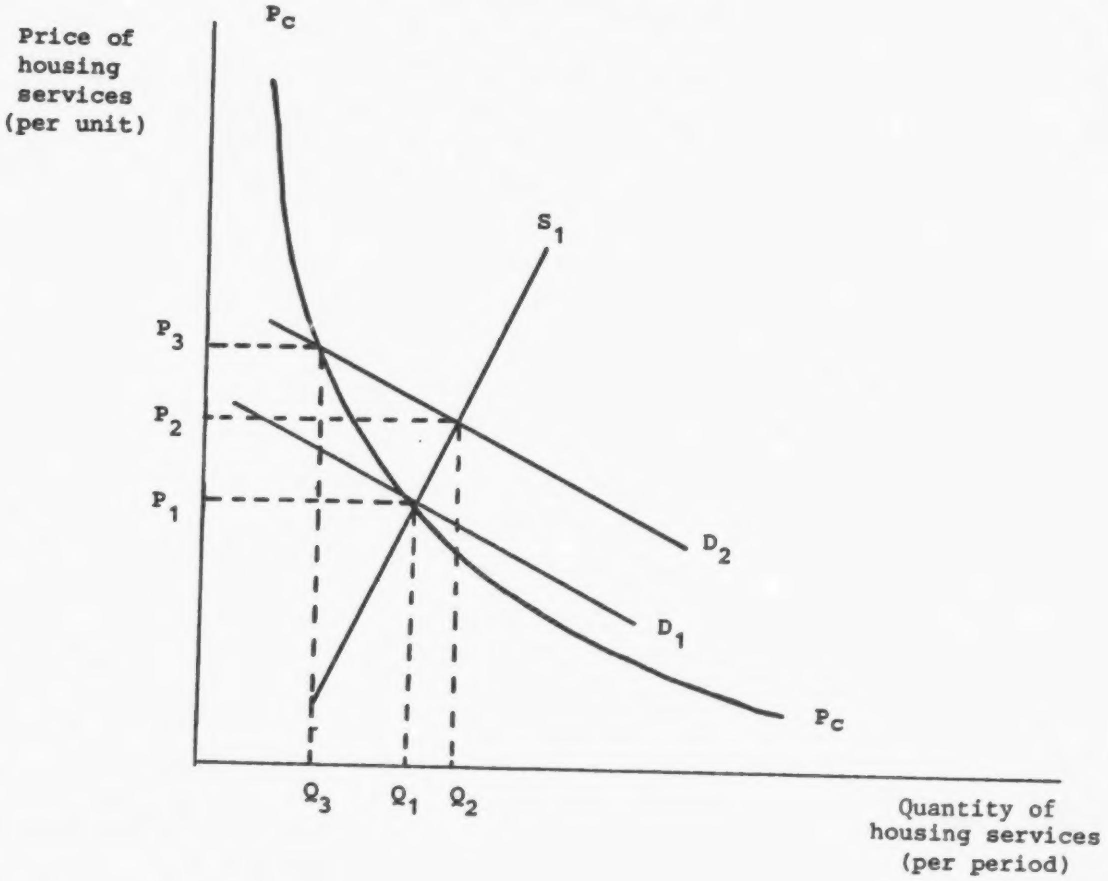
Because the quantity and quality of housing services are inextricably related in practice, economists have invented a convenient fiction: homogeneous units of housing services which make no distinction between quantity and quality of dwelling units, but refer only to those services provided by a dwelling to which tenants attach value. The intensity with which a dwelling unit produces these abstract services defines its quality.

This concept of units of housing services becomes very important when we talk about how a decline in maintenance influences the supply of housing services from the existing rental stock. Even if a complete ban on demolitions and conversions to non-rental use prevents any change in the number and composition of the stock of rental dwellings, a decline in maintenance will reduce the quantity of rental housing services supplied to tenants. In the extreme case, landlords may be able to reduce maintenance to the point that the price per unit of housing services rises above the price per unit when controls were imposed. (This would require that there be both excess demand and no or ineffective controls on the level of maintenance landlords must supply.) The point can be illustrated with the help of Figure 3-1.

Let us begin by assuming the rental housing market is in equilibrium given D_1 and S_1. Therefore the price per unit of housing services is P_1 and the

Figure 3-1

The Effect of Rent Control on the Quantity of Housing Services



quantity consumed is Q_1. Now assume that demand increases, and begins to shift from D_1 to D_2. Seeing that rents are about to rise (they would go to P_2 if nothing was done), the government puts a ceiling on nominal rents. Because in Figure 3-1 we are dealing in units of homogeneous housing services, a freeze in the nominal rent of individual units must be represented by the rectangular hyperbola $P\eta P\eta$. It indicates that controls take the form of holding constant in absolute terms the monthly rental on each rental unit. But a monthly rent is the expenditure (price times quantity) for occupancy of a particular dwelling unit. At any point on $P\eta P\eta$ price times quantity or the nominal monthly rent is constant.

If controls do not prevent landlords from adjusting the quantity of services they supply by, for example, reducing maintenance expenditures or eliminating building amenities, landlords will alter their behaviour in response to controls. If the new level of demand is D_2, they will restrict their output of housing services to Q_3. Given rent controls $P\eta P\eta$, the new price per unit of housing services will be P_3. Therefore, the central point is this: even if legislation prevents any change in the number and composition of units in the existing rental stock, the quantity of housing services supplied by this stock may decline. As a result, the actual price per unit of rental services may be above that implied by the controlled nominal rent level.

3.3.1 Existing stock: Rent controls may affect the supply of housing services from the existing stock or the number of rental units in the following ways:

(i) Conversion to uses other than rental housing, e.g., condominium or co-operative ownership or to commercial space or non-housing use. While a change of tenure may escape rent controls, at least the total supply of housing is not changed in terms of the number of units. When a rooming house is converted into office space, the total supply of housing is reduced.

(ii) Major renovation -- the quantity of rental housing services will be increased and the number of dwelling units may also be increased. Thus, the bundle of services per unit may decrease unless rents can be adjusted to reflect the larger service bundle attached to each unit after renovation. The landlord's objective is to increase the present value of his investment above what it would be without renovation.

(iii) "Deconversion" -- this is the term used in Ontario to describe the situation where a dwelling with two or more rental units is subsequently converted primarily for use as an owner-occupied dwelling -- see Chapter 6, Section 4.0. While various scenarios may occur, the net result is that the number of rental units is reduced. For example, an older large home with three 1-bedroom suites is taken over by the owner who renovates it and alters for his own use as a single family dwelling.

(iv) Demolition -- here the rental building is torn down thereby reducing the number of units in the rental stock. Where the building is old and dilapidated the loss may appear to be minimal, but for its low-income tenants it may be the best they can afford. Demolition may be followed by a new building without rental housing, with fewer, more expensive rental units -- likely to be outside controls -- or with condominium or co-operative units.

(v) Abandonment -- here the building continues to exist but the landlord walks away leaving tenants to fend for themselves. Usually utility services are soon shut off and most tenants leave. However, the building may continue to provide some form of shelter for some people. In general, abandonment will result in a net loss of rental units -- until an area is redeveloped. Then the land is likely to be put to new uses and housing units will be of higher quality and more expensive.

(vi) Changes in the level of maintenance -- we have already noted that landlords can reduce or even totally offset the effect of rent controls on the nominal level of rent for their units by reducing the supply of housing services by means of reducing maintenance expenditures. We need, however, to extend our discussion of the maintenance of rental dwellings. First, maintenance expenditures may affect:

- the quality of housing services provided by a rental unit;
- the quantity of housing services generated by a dwelling place; and
- the quantity and quality of amenities associated with a rented dwelling, e.g., doorman, recreation facilities, parking, etc.

Second, it is useful to distinguish between "cosmetic" and "structural" maintenance. Expenditures on the former involve things that meet the tenant's eye such as cleaning, painting, gardening, window washing and the extent and quality of amenities associated with the unit. A reduction or deferral of expenditures on these items will be noticed by tenants, may lead to complaints, but may or may not result in a decline in gross revenues due to higher vacancy rates or greater turnover. If a building's rent is below the market level, a decline in cosmetic maintenance may result in increased grumbling by tenants, but few if any vacancies.

Structural maintenance involves those expenditures which in the short run may not alter tenants' perception of the quality of a rental building. It includes weather protection, structural integrity, and building systems (heating, plumbing, water, electrical, elevators). Re-roofing or the replacement of an aging boiler, may or may not improve tenant satisfaction -- unless there has been a recent history of leaks or a number of lengthy periods without heat/hot water. Therefore, a "patch up and make do" approach and deferral of major capital expenditures may not reduce a landlord's gross revenue in the short or intermediate term, and such an approach is unlikely to increase the owner's or superintendent's "hassle costs", but it may increase future maintenance and repair expenditures. In particular, the failure to spend an "adequate" amount on maintenance on a regular basis could actually increase such expenditures on a present value basis. When a building or some of its basic systems deteriorate(s) beyond a certain point the damage may become all but irreversible.

Third, lowering the level of maintenance could, in time, actually result in a reduction in the number of rental units if it results in abandonment, demolition or major renovation into uses other than rental housing. (But the reverse may be the case.) A reduction in maintenance may also reduce the quantity of housing services provided by the same number and composition of rental units. Alternatively, we can say that even where the quantity of housing services is unchanged, a reduction in maintenance is likely to reduce the quality of those services. The walls may be repainted only once in ten years instead of every four. The heating system may fail once a month in the winter instead of only once per year and so on.

We can identify several alternative strategies that could be adopted by landlords in respect to maintenance. First, they could examine the detailed regulations carefully to identify the incremental benefits of incremental expenditures on maintenance. We emphasize that while traditional economic theory stresses that it is the incremental return on expenditures for maintenance that will determine the level of such expenditures not the average return on rental buildings, some landlords focus their attention on cash flow. Small landlords focus on cash flow. In Ontario, one-third of all rental units are in buildings with fewer than six units. A survey of buildings with six or more units in 1980 found that 81% of landlords owned only one building. (MOMAH, 1983, p. 16). Therefore, even though the return on additional maintenance expenditures, particularly those of a capital nature, exceeds the owner's cost of capital, his cash flow may decline. Hence, the landlord may decide not to make such expenditures. Second, landlords could decide to patch up and fix up just enough to keep the building going -- then sell the building for the best price as soon as possible -- hoping that the buyer will not realize there is a maintenance "deficit".

Third, landlords could rely on the tight rental market to skimp on maintenance both cosmetic and structural so long as it does not reduce net revenues. Rent control generally has the effect of reducing competition among landlords. In a sellers market, where rents are controlled, landlords have every incentive to cut costs because excess demand (low vacancy rate) reduces the chances that tenants will "vote with their feet".

Obviously, the landlord's ability to reduce maintenance while keeping nominal rents constant is limited by the enforcement of regulations designed to prevent such actions. Enforcement, in turn, may depend upon the vigilance of tenants and their ability to get the official machinery to work for their benefit.

It has been suggested to us that no convincing case has been made that a decline in structural maintenance will result from rent control, except those which are implicitly based on capital market imperfections. It is argued that the operating cost versus capital expenditure decisions should be unaffected by controls. On the other hand, if capital costs and operating costs are treated differently then the behaviour of landlords may be biased. Also, if the economic life of buildings is reduced (resulting from the incentive to convert), then structural maintenance may be reduced. If the optimal level of maintenance is changed by the presence of rent regulation, the present value of the "patch-up" strategy versus the capital expenditure strategy may be changed.

The main point seems to be that structural maintenance does not relate to the issue of reducing maintenance to reduce the flow of housing services. It is simply a question of the cost-minimizing maintenance strategy, given the overall plans for the building.

3.3.2 New construction: The supply of new rental units after rent control is imposed will depend, inter alia, on such variables as:

- the expectations of investors concerning the removal of controls -- in which case R_u will fall toward R_e (and R_c will rise toward the same level, ceteris paribus);
- whether or not new construction is exempt from controls "permanently" or for a fixed period, and the likelihood that controls will be imposed on newly built (now exempt) units in the future. See Stanbury & Thain (1986, Ch. 9);
- interest rates;
- construction costs;
- demand side variables, such as level and changes in household income (perhaps due to unemployment), and the rate of household formation;
- anticipated vacancy rates (a measure of the balance between supply and demand for rental units); and
- the supply of financial assistance from governments including tax benefits, subsidies, transfers, etc. See Chant (1985).

The point is that the presence or absence of rent controls or their likely extension is only one of several important factors influencing the future supply of rental units. The problem of determining empirically the effect of controls on future supply is not merely one of separating out the effects of one variable among several. (This issue is explored in some detail in Section 6.0 of Chapter 6.) The problem is that we have a counter-factual hypothesis. We are trying to estimate how many rental units (by size, type, etc.) would have been built if rent controls had not existed. Even if the number of new units falls to zero after the start of controls, that fact alone does not "prove" that controls were responsible for the decline. For example, to make the point, suppose that at the same time controls were imposed the number of households fell, income per capita fell greatly, and interest rates rose very sharply. Under such conditions, absent controls, the supply of new units would be expected to fall a great deal (except for units "in the pipeline" before economic conditions changed so greatly). (But we must also look at the composition of starts as well as their level.)

Because both the demand for and supply of housing is variegated, the supply of new housing must be broken-down by:

- type of tenure (ownership versus rental; private versus public ownership);
- location (housing is a local market, but people make trade-offs of travel time and price);
- size of units to match type/size of households; and
- timing -- when new units come onto the market relative to demand.

Even if the aggregate supply of new units simply in terms of numbers of units is not reduced by controls, the supply of housing services may not match the demand side of the market of greatest concern to policy makers. The proponents of controls in Ontario, for example, have been concerned with the supply of "decent, affordable rental housing" for low- and moderate-income households - see Stanbury (1985a). Therefore, if all of the new units produced after controls are targetted (perhaps because of construction costs) at households with above average incomes, policy makers may conclude that the supply of new units is inadequate even if the vacancy rate for new buildings is high.

Alternatively, if the number of new units does not fall after controls are imposed it may be because of massive financial assistance from governments or because of enormous excess demand which means that even high-rent units in the uncontrolled sector are occupied up as soon as they are completed. Therefore, despite controls and even the possibility they could be extended to the uncontrolled sector, profits are sufficient to stimulate considerable new construction.

4.0 DISTRIBUTIONAL EFFECTS

4.1 Introduction

Economists traditionally draw a careful distinction between the allocative effects of a public policy action and its distributional consequences. It is said that the "scientific" element of economics must be confined to the former, while distributional matters inevitably involve normative questions, e.g., who should get how much of what. In fact, as Stanbury (1985b) shows, both efficiency and the distribution of income are normative concepts. In any event, virtually no one besides some economists cares about the optimal allocation of society's scarce resources. Rather, each individual focuses his attention on the effects of rent control in terms of how it alters his own economic position in absolute terms and relative to others. Landlords are concerned about the return on their investment. Tenants focus on how much controls hold down rent levels and the rate of increase in rents. Some seem to be just as concerned about preventing landlords from earning "excessive profits" from supplying a "necessity" and ensuring that landlords do not obtain "windfall" capital gains in periods of excess demand. Politicians, if we accept the public choice approach to understanding political behaviour, are concerned with gaining or retaining the support of marginal voters (see Stanbury and Thain, 1986). For them, rent control is not a matter of allocative efficiency or of ideology, but rather a question of a policy that will "sell" with those segments of the electorate that could be retained by or attracted to their banner by such a policy. Voters and politicians both appreciate and have a healthy respect for their own self-interest, although they operate in a world of imperfect information. Will the policy make them better off? In short, everyone wants to know who gets what out of rent control. (Recall the discussion in Section 6.0 of Chapter 3.)

4.2 Assessing Distributional Consequences

Ideally, the policy analyst would be able to indicate for each individual the impact of rent control in terms of changes in his stream of income and his wealth. This is conceptually difficult and empirically impossible. Therefore, we are forced to look at distributional effects on particular groups. But what groups and characteristics are the most salient for policy purposes? The following appear to be highly relevant:

- the major actors directly affected by changes in income distribution: landlords, tenants and taxpayers in general;
- households by type of housing tenure: tenants and owners (including condominiums and co-operatives);
- geographic location of households (a province-wide scheme may only have any impact in a few centres which have a large tenant population and persistent excess demand); and
- income group (or wealth level) -- the effect of controls on low and moderate-income households appear to be of particular concern to the advocates of controls — at least judging by their rhetoric.

4.3 Discussion

While it is widely held that rent controls redistribute income from landlords to tenants, we need to distinguish between the positions of landlords at the time controls were imposed (more particularly when they were expected to be imposed) and persons who acquired rental property after controls were in place. The latter may be able to earn a normal return on his investment, although if controls are subsequently made more stringent he may also suffer a capital loss or lower rate of return than expected. In the case of Ontario it may be more relevant to say that new landlords can suffer losses if the stringency of rent controls is maintained despite the expectation that it would be reduced.

Similarly, we must distinguish between sitting tenants (those occupying a unit when controls are imposed) in the controlled sector and a prospective tenant entering the local housing market who can only find a unit in the uncontrolled sector. The former receives a monthly benefit equal to the difference between the controlled rent (R_c) and the rent that would exist if controls were absent (R_e). (The size of this benefit assumes that the quantity and quality of housing services are not reduced by a lowering of maintenance.) The latter pays a rent (R_u) that is both above R_c and R_e and may be forced to purchase more housing services than he would in the absence of controls.

The distributional consequences go even further. For example, home owners may find that their property taxes are increased because rent controls reduce the market and assessed values of rental buildings in the controlled sector. All taxpayers have to pay for the administrative costs incurred by the regulatory body responsible for implementing controls. If new construction is curtailed by controls, building tradesmen may experience a higher unemployment rate and lower incomes.

For almost any identifiable group (e.g., landlords, tenants, taxpayers), the effects of controls by income level are usually a highly important consideration. But large differences in the income levels within each group tend to be obscured by the simple categorization of the group. For example, there is the perception that all landlords are wealthier than their tenants and have higher incomes. Even if the proposition is true with respect to the average for each group, it may not be true for a significant fraction of the group.

From the perspective of ownership it is clear that "mom and pop" landlords provide a large fraction of rental units in Metropolitan Toronto. The Ministry of Treasury, Economics and Intergovernmental Affairs (1975) states that -- 110,000 landlords live in the same structure as their tenants and boarders -- over 200,000 landlords obtain rental income only as a supplement to earned income in small amounts which preclude detailed record-keeping and responses to bureaucratic requests -- a significant source of rental accommodation is provided by more than one-quarter of Metropolitan Toronto's home-owners who take in roomers and boarders.

The data in Table 3-1 indicate that 46% of rental units, excluding homes with boarders, are in buildings with seven or fewer units. In other words, it is a fairly small minority of tenants that live in large, high-rise buildings.

While these data do not prove that many landlords are poor, they do indicate that a considerable number are effectively small businessmen and women. Moreover, these data tell us nothing about the income or wealth position of the owners of the corporate landlords that have large holdings. While the direct ownership of common stock tends to be concentrated in the hands of middle and upper income individuals, indirect ownership through pension plans, mutual funds, and other institutions is more widely held.

The Ministry of Treasury, Economics and Intergovernmental Affairs (1975) found that 21% of the low-rise rental buildings were owner-occupied while another 18% were owned by corporations and 7% by non-resident aliens (defined as

Table 3-1

Type and Number of Housing Units in Metropolitan Toronto, June 1975

• Owner-occupied single family homes without boarders	184,065 units
• Single family dwellings with boarders	125,639* dwellings
• Rental buildings with 1 to 7 units	155,569** units
• Rental buildings with 8 or more units	184,065*** units

* 1-2	boarders	111,123
3-5	""	14,270
6+	""	246
		125,639

**excludes 19,979 owner-occupied units, 15,452 of which are in duplexes. Includes 37,249 single family units, 68,572 duplexes and 25,472 triplexes; the remainder are in buildings with 4 to 7 units. The total includes about 5000 units owned/subsidized by the public sector.

***excludes about 35,000 units owned/subsidized by the public sector.

Source: Ministry of Treasury, Economics and Intergovernmental Affairs (1975).

living outside the Municipality). The balance, 54%, were owned by individuals or jointly. Forty percent of owner-occupied single family dwellings have one or more boarders living in them. It appears there are about 200,000 boarders living in 125,600 single family dwellings. While boarders are not subject to rent control, they constitute a substantial segment (perhaps 20%) of the total number of persons living in rental accommodation. In general, many boarders are comparable to low-income tenant households. While rent control is justified, in part, as a program to aid low-income households, the exclusion of boarders - largely for administrative reasons - seems odd indeed. See Jaffray (1984).

MOMAH (1983, p. 15) indicates that in 1981 some 33.8% of rental units in Ontario Census Metropolitan Areas were in buildings with fewer than six units while 49.9% of units were in buildings with 50 or more units. (This means that 37% of all tenant households live in buildings with 50 or more units.) A survey covering about 70% of the province's rental stock in buildings with six or more units in 1980 (including Metro Toronto and Ottawa-Carleton) found that 81% of landlords owned only one building. These buildings (which accounted for 48% of the rental units in the sample) were owned by individuals (26.4%), husband and wife (19.8%) and partnerships (16.8%). Corporations or numbered companies owned one-third of the single-building enterprises. The data also indicate that corporate owners tended to have larger buildings, e.g., 67.4% of all units in buildings where the landlord owns only one building were owned by corporations or numbered companies.

5.0 SECONDARY AND INDIRECT EFFECTS

There may well be disagreement as to what constitutes a primary effect of a system of rent controls and those that are secondary or indirect. We have classified allocative effects as primary and placed the distributional consequences of controls in an entirely separate category. This approach reflects the bias of economists, although our experience as policy analysts has made us aware that in political terms rent control is just another battle by interest groups over the distribution of income and wealth -- see Hartle (1984), Stanbury and Thain (1986) and Stanbury (1985a).

5.1 Type of Effects

In this section we define and discuss briefly some of the other consequences of rent control. We have identified four categories:

(1) Effects on Governments

- **Revenues:**
  - Rent controls may reduce the market value of rental properties. Given the same property tax rate, rent controls will result in lower local tax revenues. If the same amount of total revenue must be raised, other property owners may be taxed more or other types of taxes imposed, e.g., a local income tax, higher user charges. (As we noted above, this would not occur in Ontario because property taxes are based on assessed-values frozen in the early 1970s). Where controls reduce construction-related employment, income tax revenues will fall.
  - Part of the controls system may involve tax abatements on rent-controlled properties, thereby reducing the tax base of local governments.
  - The amount of unpaid property taxes may increase as a result of abandonment induced by long-term, stringent controls. (With respect to New York City, see Stegman, 1982.)
  - Tax expenditures (i.e., reduction in tax revenues) may be increased in order to stimulate the construction of new rental units where controls have reduced it.
- **Expenditures:**
  - Budgetary outlays for the administration and enforcement of rent controls will increase total public expenditure, all other things being equal.
  - There may be an increase in direct subsidies or grants by public authorities to stimulate new construction which has been adversely affected by controls. See the argument by Patterson (1985).
  - There may be reduced social welfare transfers attributable to the greater affordability of rental housing as a result of controls.

- "Tarbaby" Effects: rent controls may well generate demands for other forms of regulation or government intervention such as:
    - zoning controls by local governments to prevent rental units from "escaping" from controlled stock by conversion, demolition, or re-development as 'luxury' (exempt) units (Similar controls may also be incorporated directly into the rent control statute);
    - additional regulation to prevent under-maintenance (so-called code-compliance provisions);
    - controls over side payments (e.g., key money);
    - controls over discrimination by landlords against tenants seeking to enforce their rights regarding rent controls and security of tenure provisions; and
    - increased pressure for public subsidies to offset any decline in the new construction of private rental buildings attributable to controls.

(2) Non-price Rationing Effects:

- Tenants may experience higher search costs attributable to lower vacancy rates which are often associated with controls.
- Landlords, where there is excess demand, may be able to select their tenants on the basis of personal characteristics such as level of income, race, ethnicity, number of children, with a view to reducing their costs or indulging their tastes and preferences.
- Landlords are likely to experience higher transaction costs where strong security of tenure regulations accompany rent controls.
- The private rental market may atrophy if stringent controls persist over long periods and may be replaced by public housing as occurred in Britain.
- We should expect to see efforts to evade/avoid controls, some of which may be illegal, e.g., "key money" (a form of suppressed price rationing);

evasion by landlords, e.g., charging illegal rents; failure to maintain the building; and mutual evasion by landlords and tenants ("contracting out").

(3) Psychological Effects:

- Controls are likely to influence the expectations of the potential suppliers of new units and this could adversely affect future supply.
- Rent controls could reduce tenants' anxiety regarding the risk of 'gouging' by landlords during periods of excess demand. Controls over eviction may have the same effect.
- Rent controls may have value to politicians as a symbolic gesture in the form of a "consumer protection" measure -- even if they have only a very modest impact in assuring there is an adequate amount of "decent, affordable housing".
- Controls may produce a loss of respect for "the system" if there are widespread violations by landlords and flourishing grey or black markets.

(4) Other Behavioural Effects:

- Tenant mobility may be reduced. This affects both labour supply and may result in over- and under-consumption of housing due to the "lock in" effect of controls that create a large gap between R_c and R_e.
- There may be an increase in rent-seeking activities by tenants to maintain the system and by landlords to eliminate it. In other words, tenants may use resources becoming more politically active pressuring politicians to retain or even string their rent controls.
- The landlord population (through the turnover of owners) may change toward persons who are more adept at manipulating control regulations and/or more willing to "evade" controls by reducing maintenance or setting rents above the legal level.

5.2 Discussion

First, while homeowners may think that rent controls are of little or no concern to them, they may find that if controls reduce the assessed value of rental buildings in the controlled sector that their property taxes could rise to maintain the same level of public spending. Whether this actually occurs is hotly disputed in the literature on rent control. See, for example, Appelbaum and Gilderbloom (1984). Homeowners may be adversely affected in another way. If controls lead to a "drying up" of new privately-initiated construction of rental buildings and if the demand for rental accommodation grows significantly, there may be strong pressures on politicians to subsidize the building of new rental units. This can be done in a wide variety of ways but all involve some form of tax expenditure ("giving by not taking") and/or cash transfers to tenants or landlords. Indeed, some tenant activitists and proponents of rent control wish to see the private rental market reduced in scope and ultimately replaced by public rental housing or by widely-subsidized ownership housing. Stringent rent controls may, in time, effectively result in the atrophication of the private rental market as occurred in Great Britain. See Patterson (1985) and the table on page 6-67 below. The necessarily expanded role for governments will result in higher taxes and existing homeowners will be paying part of the bill.

Second, taxpayers have to pay the costs of administering the rent control regime. We note, however, that some jurisdictions impose a levy on rental units in the controlled sector to help offset the burden falling on taxpayers (e.g., stabilized units in New York).

Third, rent controls, like other forms of direct regulation, unless they are abolished outright, tend to become more complex over time and to stimulate the growth of ancillary legislation. They grow more complex because experience always brings to light anomalies, contradictions and counter-intuitive effects that gore someone's ox. The search for "perfect justice" is endless; each set of refinements simply leads to another. This illustrates the important point that while controls may have originally been justified as necessary to prevent "gouging" during an "emergency" in the rental housing market, they are soon adapted to achieve other objectives such as maintaining the affordability of rental housing and redistributing income in kind among certain groups of tenants - see Stanbury (1985a).

Moreover, gaps or weaknesses in the controls legislation often lead to additional legislation to deal with the undesireable consequences of controls. For example, the City of Toronto has acted to prevent demolition of rental buildings even though the demolition met the criteria of the rent control legislation -- see Chapter 6. The point is that rent controls have a "tarbaby effect" -- they generate more government intervention.

Fourth, rent controls, like any form of price controls that bind, generate non-price methods of rationing. This occurs because at the controlled rent, the quantity demanded exceeds the amount sellers wish to provide. The contrived scarcity has to be rationed by ways other than an increase in price. Tenants wishing to move or prospective tenants entering the jurisdiction where controls are present may have to expend more effort searching for a controlled unit. The cost of moving for a sitting tenant will be increased if the system of controls incorporates a vacancy decontrol provision, i.e., after a tenant leaves voluntarily the landlord can raise the rent to the market level, although subsequent increases may be subject to controls.

As we discuss in Chapter 4, there is seldom perfect fidelity to any control regime. Where the gap between R_e and R_c becomes substantial, strong incentives are set up for landlords to evade or avoid controls. They may demand "key money" from new tenants when an attractive, controlled unit becomes vacant. Moreover, if the authorities are unable (or unwilling) to prevent a reduction in maintenance expenditures, landlords and tenants may jointly "opt out" of the control regime and bargain a rent above the legal level. Indeed, we argue in Chapter 4 that some "looseness" in a system of controls may actually make it work better by reducing the gap between R_e and R_c. However, it will do so in a discriminatory fashion, i.e., the gap between the legal controlled rent (R_c) and the actual rent in the controlled sector (R_c^*) will vary across tenants and landlords - recall the discussion in Section 3.0 above.

Where grey or black markets expand beyond a certain point -- and it is difficult to say when this will occur -- tenants, landlords and regulators can become demoralized and cynical about the control system. Violations formerly seen as a way of "living with controls", when they become too widespread, bring the control regime, and possibly other forms of government regulation, into disrepute. A kind of Gresham's Law begins to assert itself. The ultimate result could be the breakdown of the system of controls -- it becomes more honoured in the breach than in the observance.

Fifth, if rent controls do produce a substantial rent gap of the type discussed above in section 3.0, they create two conflicting interests. Tenants have a pecuniary interest in maintaining controls, and, as we know people are loss averse so they are likely to fight in the political arena to keep controls in place. Landlords, even those who "bought in" after controls were imposed, have an incentive to try to persuade government to remove controls. Therefore, we would expect to see an increase in rent-seeking behaviour (see Hartle, 1984; Stanbury and Thain, 1986).

Sixth, if the intertemporal pattern of controls is such that landlords can only earn a normal rate of return by being masters of the "rent control game", we would expect that, in time, landlords best able to play the game will become predominant. For example, if normal profits can only be earned by skimping on maintenance (ignoring the complaints of tenants and relying on the regulator's inability to enforce maintenance standards), and by aggressive utilization of all the provisions and loopholes in the rent review process, then landlords will have to adapt their behaviour. Alternatively, they may give way to other persons more willing and better able to do so.

Finally, we note that all types of government intervention -- and rent controls are no exception -- alter people's expectations, sometimes in ways that are hard to predict or even fathom ex post. As we discuss in Framework 3 in Chapter 4, in the real world not all actors optimize, many "satisfice", to use Simon's (1955, 1956, 1957) term. Moreover, everyone is not equally well informed and information is costly. Expectations may be formed on the basis of simple heuristics that change only long after it is apparent they are misleading the decision-maker. Therefore, we emphasize that all the effects of rent controls operate through the perceptual glasses of individuals. Actions by regulators and politicians may have either more or less significance than they believe is the case.

The exemption of new construction is usually intended to ensure that rent controls do not adversely affect the future supply of rental dwellings. Yet potential investors may be "scared off" building new rental units because they expect the exemption to be temporary. They may, on the basis of the history of other jurisdictions, conclude that controls will be extended in the future during a period of great excess demand. In Chapter 4 we note how the level and pattern of allowable increases will affect the expectations of landlords and tenants and hence the ultimate effects of the control system itself. For example, if there is a guideline rate of increase suggested, landlords may find it easier to obtain that rate of increase from tenants than they would in the absence of controls.

6.0 THE ACTORS' PERSPECTIVES ON EFFECTS OF RENT CONTROLS

In this section we try to assess the handful of most important effects of rent controls for the three most important actors who have to deal with them. We begin with the tenant's perspective because it is his or her name that controls are enacted. We then move to the landlord's perspective - they are usually seen as the primary loser under controls. Finally, we look at controls from the perspective of the politician. Controls come into existence, are modified and are removed as a result of political decisions. However, these decisions stem from the politician's assessment of where the votes are. To continue in existence rent controls must meet the test of the political marketplace.

6.1 Tenants' Perspective

In our view, the five most important effects of rent control from the perspective of tenants are the following:

- The amount by which the controlled rent is held below the level that would prevail in the absence of controls. Note that rents in the uncontrolled sector will exceed the level that would prevail were controls absent -- see Fallis and Smith (1984b), and Marks (1984b).
- The rate of increase in rents over time relative to the change in the tenant's income and the increase in consumer prices generally. A related issue is the affordability of rental housing. It is usually measured by the ratio of rent to income, but obviously the denominator of the ratio has nothing to do with rent controls.
- Economic security of tenure: rent controls usually provide protection against very sharp increases in rent during periods of excess demand that might otherwise result in "economic eviction" or severe hardship.
- Changes in the quantity and/or quality of housing services. Tenants want to see that the level of maintenance and amenities do not suffer as a result of controls.

- The tenant's feeling of power vis-a-vis the landlord as the government favours tenants over landlords. This feeling is probably closely tied to points two and three.

We believe that the following effects are generally less important to tenants.

- Vacancy rates -- a lower rate implies greater search costs for mobile or prospective tenants. But vacancy rates depend upon both demand and supply and controls operate largely on the supply-side of the market.
- Effect on savings, e.g., ability to acquire a house more quickly by being able to save the difference between R_e and R_c.
- Mobility -- reduced incentives for residential mobility and effects on the adjustment of the labour supply to changing demand. (As we note in Chapter 6, while vacancy rates have declined in Ontario since 1975, tenant turnover rates remain high.)
- Effect on the tenant's relationship with his landlord. Our hypothesis is that a landlord who is being harmed economically by controls will be unhappy and this will result in a less amicable relationship with the tenant. Indeed, controls create an adversarial relationship usually absent in decentralized, competitive market processes.
- The costs of political activity to maintain controls (a form of rent-seeking behaviour) and the costs of fighting proposed rent increases before the rent control agency. As we note in Chapter 4, there are economies of scale for both landlords and tenants in dealing with the agency that regulates rents.

6.2 Discussion

The critical issue for tenants is the amount by which rents are held below the level that would prevail in the absence of controls and the rate of increase in rents relative to their income. Rent controls can "smooth out" increases in rent over time -- hence they reduce uncertainty. While tenants are well aware that the benefits of controls can be greatly eroded by a decline in maintenance, it is difficult for them to specify their trade-off between the two variables. Their strategy appears to focus their efforts on keeping rents down, where there is greater certainty about the benefits of tenant action, and then, secondarily, try to see that maintenance doesn't suffer too much.

In general, rent control regimes are designed to favour sitting tenants, almost always without regard to their level of income (except where "luxury" units are exempt). Higher search costs attributable to lower vacancy rates because of a slowing in the growth of the supply of new units due to controls are seen as irrelevant to the tenant who has no desire to move. Similarly, the tenant who wishes to stay put is not worse off by the fact that the average level of mobility is reduced. Where home ownership is not the ultimate goal of a tenant, lower rents simply free up disposable income for other uses, e.g., a new car, travel, etc. In any event, low, controlled rents would tend to increase the gap in the price of housing services between the rental and ownership markets making the former more attractive even if tenants can acquire the downpayment on a house sooner.

There is another breakdown of tenants that may be worth noting. Within the controlled sector there are several groups of tenants including (i) transient tenants (planning to own as soon as possible), (ii) "permanent" tenants of adequate means, (iii) elderly tenants who may have low income, but a fairly short time horizon, and (iv) permanent tenants who are younger and have a low income (i.e., renters because they are unable to buy). A more complex and subtle analysis should take into account the different interests of these four categories of tenants.

While landlords may resent being "taxed" by rent controls for the benefit of their tenants, their ability to inflict their frustration on tenants is usually limited by the various legislative protections that accompany rent controls. So the landlord grumbles -- so what. "The rent is a bargain - so why worry about the grumbling" might be the approach adopted by tenants.

As for the costs of political activity to maintain controls and to fight rent increases before the regulatory body, they are modest when a tenant is a resident of a large complex. There is an irony here. In Ontario, for example, some of the strongest proponents of controls are individuals working for agencies whose objective is to help low-income households -- and they are financed largely by government funds. In any event, political entrepreneurs may find it attractive to advocate that rents controls be maintained or strengthened -- hence the organization of an overt tenant pressure group may be unnecessary. One has only to think of the announcement of the Conservative government in Ontario, just prior to the 1985 election campaign, that they would, if re-elected, make rent controls more stringent. See Chapter 5.

6.3 Landlords' Perspective

Landlords are particularly concerned about the amount by which rents are held below that level that would produce a normal rate of return given the riskiness of the owner's investment. This rent gap can be reduced by cutting back on maintenance and on capital repairs to some extent, but most control regimes seek to prevent this behaviour. Therefore, the landlord is concerned about the stringency of code compliance regulations and other regulations that seek to prevent a decline in maintenance.

The net effect of controls in an efficient capital market will be summarized in the market price (capital value) of the owner's building. Essentially, the market should capitalize the difference in the expected stream of net income and the residual value of the building attributable to the imposition of controls. Therefore, as we have noted, it is essential to distinguish between owners at the time controls were announced/imposed and those that acquired rental buildings after controls have been in operation. Presumably subsequent owners earn a normal return because the price they pay fully incorporates the adverse effects of controls. (This may not occur if they fail to anticipate a subsequent tightening of controls, i.e., a future reduction in net income or the residual value of the building.)

In addition, landlords are concerned about the rate of increase in the allowed level of rents relative to their increase in costs -- this affects both net cash flow and effective rate of return on investment. Indeed, as we have noted above, it is the size of the rent gap (R_e - R_c) that has the greatest influence on allocative efficiency.

If controls reduce the vacancy rate in the controlled sector they may reduce the riskiness of owning rental buildings, although they are also likely to reduce the expected rate of return. At the same time, the existence of controls will tend to increase the riskiness of building new units even if they are exempt from controls because of the possibility of the exemption being removed.

Finally, we note that landlords have to consider the costs of political activity to fight for the removal or loosening of controls and the costs of seeking higher rent increases before the regulatory authority. (In Chapter 6 we provide data on how successful landlords were in Ontario at obtaining rent increases above the statutory rate.)

Rea and Gupta (1982b) offer a categorization of rent control regimes as "moderate" or "restrictive", as seen by landlords, in terms of the following schema:

	Type of Control System	
Design Characteristic	Restrictive	Moderate
• rent increase	in the discretion of a rent control board	pegged to a fixed annual percentage
• vacancy decontrol	not allowed	allowed
• rent rollback	rollback to some previous level	none
• eviction regulation	regulation to protect tenants from unfair practices	none
• new construction	not excluded	excluded from controls
• conversion to condos	controls to prevent conversion or demolition	no controls over conversion
• rent control boards	composition not specified, e.g., elected	composition specified, i.e., some landlord reps.
• expiration date	none	specific expiry date in the legislation

Gupta and Rea (1984), on the basis of a sample of San Diego landlords, conclude that the first three characteristics are the most important determinants of the relative restrictiveness of a system of rent control.

6.4 Politicians' Perspective on Rent Controls

Given the fact there are far more tenants than landlords, that tenants are concentrated in urban centres, that homeowners seem to be sympathetic toward rent controls, it appears that politicians (in urban ridings) will attend fairly closely to tenants' interests. The survey data in Table 3-2 indicate that after nine years of rent control only a small fraction of tenants (13%) and homeowners (21%) believe rent control should be abolished. Moreover, a substantial majority believe it should be extended to cover all rental housing rather than the 75% in covered in 1984. Perhaps owners and tenants support for rent control stems from their perception that there is a "serious shortage of affordable

Table 3-2

"Yes" Responses to Policy Oriented Questions

	Tenants	Owners	Total
1. Rent control should be abolished	13	32	18
2. Rent control should cover all rental housing	73	58	63
3. There is a serious shortage of affordable housing in Ontario	73	61	65
4. Government should use more tax dollars to provide rental housing for low income people	77	67	70
5. The federal government is doing a good job of providing affordable housing	19	21	20
6. The provincial government is doing a good job of providing affordable housing	22	24	23
7. Your local goverment is doing a good job of providing affordable housing	26	28	28

Source: Pringle (1985, pp. 182-183) citing a survey of 5000 households in Ontario's 10 largest cities by Environics in early 1984.

housing in Ontario." Seventy-three percent of tenants and 61% of homeowners believe this is the case. A slightly higher fraction believe that government should use more tax dollars to provide rental housing for low income profile (77% and 67%, respectively). Only one-fifth to one-quarter of owners and tenants feel that each of the three levels of government is "doing a good job of providing affordable housing". See Table 3-2. With these public opinion data, it is clear why all three parties in Ontario support rent control and support larger public subsidies to create more affordable housing.

We suggest that for politicians the most salient effects of rent controls are the following:

- The rate of increase in controlled rents relative to (i) the increase in the average tenant's income; (ii) the recent history of rent increases; and (iii) the perceived increases in landlords' costs (the possibility of excess returns or windfall gains).
- Widely-held tenant perceptions of a decline in maintenance standards and the loss of amenities (doorman, recreation facilities). Poorer maintenance means that the benefit of controls to tenants is reduced.
- The ability of the system of rent control to protect particularly vulnerable groups such as the poor (particularly with large families), the elderly, the handicapped and single parents with children (working or on welfare).
- Well-publicized evidence of considerable violations of the rent control system: illegal rents; key money; questionable conversions to uncontrolled units. These types of behaviour bring the whole system of controls, or at very least their enforcement, into disrepute.
- Vacancy rates sufficiently low that mobility is seriously inhibited and the search costs of prospective tenants for a controlled unit are high leading to public criticism of rent controls.

We wish to emphasize that controls may be advocated in the name of the poor, the immobile elderly and disadvantaged minorities. However, their persistence (and indeed their original enactment) is largely attributable to the politics of catering to the interests of the much larger number of non-poor, non-elderly and non-disadvantaged -- see, for example, Kochanski (1980), Baar (1977), Shulman (1981). Rent control is a tribute to the political effectiveness of the middle class (see Director, 1958). They are the prime beneficiaries in economic terms and they are numerous. Moreover, they are used to articulating and focusing their concerns on politicians. They know the political ropes and use them to advance their interests. Rent control, in fact, is a public policy supplied by politicians in the hope of gaining the votes of non-poor tenants. See Stanbury & Thain (1986).

Chapter 4

THE RELATIONSHIP BETWEEN DESIGN CHARACTERISTICS AND EFFECTS: THEORIES AND ANALYSES

The purpose of this chapter is to analyze the relationship between the design characteristics of systems of rent regulation and the effects associated with those characteristics. Metaphorically, we can think of the design characteristics as a set of piano keys. What we want to understand is how a particular chord is produced by striking which combination of keys. Furthermore, the order in which we strike the keys will produce different melodies. Ideally, we wish to be able to understand how the set of effects of a system of rent regulation is changed by altering a particular design characteristic. Obviously, this is an ambitious task.

1.0 THE METHOD AND PURPOSE OF THE THEORETICAL ANALYSIS

The analysis of design characteristics of systems of rent regulation is complex. It must consider such variables as (i) the nature of the rental housing market and the specific responses of the different participants in that market (e.g., landlords, tenants, governments); (ii) the impact of other relevant markets on the rental market (e.g., the homeownership market); (iii) changes in socio-demographic variables (e.g., household formation processes); and (iv) the macro-economic environment (e.g., interest rates, inflation, real growth). The analysis must consider not only immediate consequences and long-term impacts, but also the time path of the rent control system as it adapts to changes in the environment, to changing expectations, and to shifts in the behaviour of participants, including the regulators.

To deal with such a complex task one must "decompose" the analytical process and consider the fundamental consequences of specific design characteristics of the rent control system under certain, admittedly, stylized scenarios. That is, certain assumptions must be made about rental markets and the economic environments in which they function. The analysis can then proceed to the estimation of the specific effects of certain combinations of design characteristics, especially those with features that in all circumstances consistently nullify or reinforce specific effects of rent control systems. For example, without some safeguards for security of tenure, other rent control provisions may have little effect. The theoretical analysis will identify those features of a system's design which can be dealt with in isolation, since they have minimal impact upon the operations of other characteristics of the program.

The theoretical analysis will also provide the policymaker with a conceptual framework relating design characteristics to effects and to policy objectives. Indeed, it will point out in some instances that the logical consequences of specific provisions in the control system are counter-productive in terms of the objectives for which they were introduced. The relative weaknesses of our theories in explaining the responses of the rental market means that emphasis must be placed on learning from actual experiences with rent control systems. (See Chapter 6 for details concerning the Ontario system.) Since controlled experiments with broad purpose social programs are rarely feasible for political reasons, one must rely upon theory to interpret experiences of the various rent control systems including that of Ontario. Thus theory provides an analytical framework which permits the identification of confounding effects in the empirical study of rent control systems. At the same time, we emphasize that when we come to offering suggestions for policy in regard to a specific system of controls it is absolutely critical that these be based on a care assessment of the "fact pattern" that applies to that system. Effective policy analysis requires that legal, institutional and political realities be carefully considered as well as theory if the policy recommendations are to be relevant and useful. All rent control systems operate within a web of many other public policies that shape behaviour in the rental housing market. In addition, macro-economic variables strongly influence that market.

The variety of types of effects, time periods and design characteristics which the theoretical analysis of a rent control system must address strongly suggests the employment of several theoretical frameworks. Each provides assessment of consequences from a particular perspective. Each framework obtains its perspective by focusing on certain dimensions of the environment in which rent controls operate, and makes certain assumptions with respect to the operations of the rental housing market. A change in assumptions (i.e., a change in a framework) provides another perspective of the market, capturing different aspects of the operations of the market as it responds to the rent control system. Each framework used in the analysis can provide insights and predictions which are missed by the others.

2.0 THREE ANALYTICAL FRAMEWORKS

We propose to analyze systems of rent control from the vantage point of three frameworks, the central characteristics of which are summarized in Figure 4-1. Our general approach is to move from the most common set of assumptions used by virtually all economists analyzing rent control to other sets of assumptions that provide a richer and more complex basis for analysis. The three frameworks within which we analyze the relationship between the design characteristics and effects of systems of rent control should not be viewed as "competitive" approaches. Rather, they are complementary as each illuminates better than the others some important aspect of the relationship.

The major differences in assumptions between the frameworks concern (i) the information which participants in the rental housing market have with respect to its present status (e.g., knowledge of quality adjusted prices, availabilities) and its future circumstances, as well as knowledge of other relevant markets;

Figure 4 - 1

Characteristics of Three Frameworks Relating Rent Control Systems to Their Effects

Characteristics/ assumptions	Framework 1	Framework 2	Framework 3
• Time period	(a) long run (b) short run	short run	short run (and long run?)
• Information	perfect	imperfect	imperfect
• Fidelity to the regulatory regime	complete	partial (regulatory failure)	partial (regulatory failure)
• Economic optimization by landlords and tenants	yes	yes	no; bounded rationality; non-maximizing behaviour
• Dynamics	no; comparative statics	no; comparative statics	yes

(ii) the type of choice criteria used in the market (e.g., do landlords maximize yields?); (iii) the structure of transaction costs faced by tenants and landlords; and (iv) the fidelity of regulators, tenants and landlords to the regulatory provisions (e.g., are side-payments made? Are penalties enforced?). The frameworks also vary in respect to the time period under consideration and the extent to which they address the time path of the system (i.e., dynamics of adjustment between equilibria).

Framework 1 is the one which is the most fully developed in the economic literature and provides a powerful lens with which to understand the long-term adjustment of the market to fundamental economic changes. It also provides a normative framework with which to analyze the impact of systems of rent control in terms of the efficient allocation of resources. This framework assumes that tenants and landlords are rational and that they maximize their utilities and profits respectively. Decisions are made with complete information, i.e., no uncertainties exist in the market. The markets in which people trade are assumed to be competitive. (We shall elaborate on this assumption.) Most of the models within this framework are static. The adjustments of the market over time are captured by comparing two snapshots of the system at different points in time -- the short-run where adjustments in the supply side of the system are very limited and the long-run which permits much more extensive adjustment in supply.*

These so-called comparative static models are augmented by dynamic control-models, which identify the optimal behaviour of participants over time. (We note, however, that the restrictive assumptions which characterize these control-theoretic models limit their practical usefulness. Moreover, such models require types and volumes of information far beyond that which is available.)

The second framework uses many of the same assumptions as the first, except that it recognizes explicitly that information is imperfect (uncertainty exists) and, therefore, expectations play a role in the decisions of various participants in the rental housing market. Framework 2 also recognizes explicitly the existence of transaction costs and the fact that regulations are not automatically obeyed or work exactly as designed. For example, some landlords and tenants may ignore rent controls; side-payments may be exchanged, and penalties may be inadequate to deter illegal behaviour. In a stable environment, with clear feedback (i.e., where both tenants and landlords learn quickly from experience) a long-run model in Framework 2 will have conclusions that approximate those of models in Framework 1 where transaction costs exist and the costs of breaching rent controls are internalized. In a turbulent environment, where learning by landlords and tenants is much more difficult, the long-run consists only of a sequence of short-run decisions. This is the reason why in the table we identify only a short-term perspective in Framework 2 in Figure 4-1.

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* In the housing market the longevity of the economic life of the existing stock means that a significant impact upon supply may take five or ten years to occur. Therefore, the short-run in this market could be as long as a decade.

The third framework we shall use to analyze the consequences of different systems of rent control incorporates behavioural or bounded rationality models. These models recognize that landlords do not necessarily maximize profits and that tenants do not necessarily maximize utility. Moreover, information is assumed to be imperfect and is not allocated symmetrically in the market, e.g., the poor and the elderly are less well informed. Decisions in the market are assumed to often reflect habits and standard operating procedures more than a calculated effort to obtain maximum benefit -- subject to constraints -- on the part of landlords or tenants. The models grouped under Framework 3, which reflect the work of Simon (1955, 1956, 1957), provide the analysis of effects with more realism and detail but at a cost of less analytical tractability and predictive power.

3.0 THE NATURE OF THE RENTAL HOUSING MARKET

Before developing each framework in more detail, it will be instructive to identify some of the rental housing market's essential features, their relationship to the emergence of rent controls, and the justification of these controls.

Rothenberg (1975) has identified the following distinctive structural features of a housing market which we shall discuss below: location, durability, importance of the capital market, heterogeneity of the stock and its services, convertability of existing unit (e.g., change in the type of use or service); conversion of quality, moving costs (change in consumption of housing is costly in terms of time and money; in search, acquisition and physical moving, and regulatory constraints (zoning, health and building codes).

3.1 Location

There is no single "housing market". Indeed, the housing market consists of geographically separate or overlapping markets related to certain social amenities and accessibility to places of employment. These markets may appeal to different segments of the population and are only partially substitutable for one another. Changing demographic and economic patterns mean shifts between markets and prices moving differently in local markets. (This fact is important for the analysis of rent controls, since one aspect of rent controls is the impact they have upon rent equalization irrespective of local shifts in demand.)

3.2 Durability and the Relationship of Rental Housing Markets to Capital Markets

The structural factor of durability implies that at any given time the most significant portion of the market consists of the existing stock, and that the supply of new units in any year is marginal to the total. (We note, however, in the mid-1960s the ratio of apartment starts to the total stock of apartment units in Ontario exceeded 10% for several years. See Kalymon (1981).) This fact means that unanticipated rapid increases in demand for rental units resulting from demographic shifts or increases in income will lead to high rent increases since the supply schedule is relatively inelastic in the short-run (several years). Indeed, smoothing of the market's path of adjustment to prevent "gouging" induced by "temporary" shortages has been a major argument for rent controls in many jurisdictions. Controls were implemented in Ontario in 1975 in response to cries of "gouging" and "unconscionable increases" in rent -- see Stanbury and Thain (1986).

Durability means also that there is a strong relationship between the housing market and national capital markets, notably to interest rates. The acquisition of a rental building represents a large investment for the landlord, which he makes in anticipation of a future stream of incomes. In making this investment he compares it to other investments available in capital markets. The size of the investment means that a large portion of it is typically financed by borrowing. New construction is even more sensitive to swings in interest rates than is the turnover of the existing stock.

3.3 Heterogeneity

Durability and the slow augmentation of the stock by means of new construction imply heterogeneity of the stock, in terms of its age distribution, as well as location and other characteristics. Heterogeneity also reflects the fact that a unit of housing provides a stream of different types of services accommodating the different needs and tastes of tenants. Housing markets provide a variety of types of dwellings, hence tenants can choose units which fit their subjective preferences for trade-offs among different features of the unit (e.g., rent level, number of rooms, appliances, location, amenities, age). As we shall argue later in this chapter, a decline in vacancy rates or mobility of some tenants, because of rationing effects induced by rent controls, leads to some welfare loss for society as a whole. This occurs when needs or tastes change, but an appropriate adaptation of consumption is not possible. This welfare loss is added to the loss resulting from over- and under-consumption of housing services as a result of controls -- see Stegman (1982, p. 115-119) and Pringle (1985, Ch. 4).

3.4 Convertability

The degree of convertability of units in the housing market from one type of use (e.g.,rentals) to another (condominiums) affects the operations of the market in the short-run even without the exercise of such an option. If, for example, the option value of conversion increases over time, landlords of rental units may require lower rents because of the higher future value of their building in another use. Therefore, regulations that reduce the degree of convertability will have a direct impact on the level of rents deemed sufficient to achieve a normal return on invested capital, given the riskiness of the investment.

3.5 Moving Costs

Marginal adjustments in the consumption of housing services are difficult to make because of transaction costs. High search and moving costs are often cited as another reason for the need to protect renters' security of tenure in an effort to offset the market power of landlords. However, as Stanbury (1984a, Ch. 4) noted, these transaction costs are reciprocal.

3.6 Other Regulatory Constraints

The final structural aspect of the housing market relates to the large role government regulation already plays in the market and the legitimacy of the "public interest" in housing markets. Indeed, the legitimacy of regulation is already established, and only the tactical choice of its extent is debated. In addition to regulation, vast amounts of public money are poured into housing markets (both ownership and rental) in the form of subsidies and tax expenditures. See Chant (1985).

The important operational consequences of these structural features can be summarized as follows:

- new units are typically a small proportion of the stock;
- information about alternatives (because of the variety present in the market) is imperfect;
- transactional friction is important (i.e., it is one reason why below-normal vacancy rates in a given market may have a severe impact upon rents); and
- the rental housing market is vulnerable to changes in macro-economic variables, in particular, to changes in interest rates and to inflation.

Lett (1976a, p. 34), reviewing Rothenberg's (1975) analysis, concluded: "Most of the foregoing suggests that timing is very important in the housing market.

Indeed, they even raise the question of whether equilibrium ever exists in any but very special limited circumstances in the housing market". While we would not go this far, we do agree that timing is of critical importance in dealing with the rental housing market. For example, tenants may be able to obtain substantial immediate benefits from the imposition of controls while the costs are delayed for some years (except for the pecuniary losses of existing landlords). Given the relative number of tenants and landlords in most major cities, political realities coincide with the natural human desire to obtain benefits in the present and delay (and shift) costs as long as possible. Therefore, a useful analysis of rent control must take into account the timing of its effects. Frameworks 2 and 3 give more emphasis to this issue.

4.0 FRAMEWORK 1

4.1 Assumptions

The basic assumption which most economists who have studied rent controls make with respect to individuals in the rental housing market is that they are perfectly well informed, that they engage in rational, self-interested behaviour, and that they maximize their utility subject to some feasibility constraints (e.g., tenants choose within some budget constraints). Indeed, both individual landlords and corporate landlords are assumed to be strict profit maximizers. Typically the assumptions which are made with respect to the housing markets are the following: (i) there are a large number of buyers and sellers; (ii) no participant by himself can influence the prevailing prices in the market, i.e., the volume of the transactions of an individual are small compared to the aggregate volume of transactions in the market; (iii) there is perfect information; (iv) entry and exit to the market is easy; and (v) the good that is traded in the market, rental services, is homogeneous.

The last assumption requires considerable abstraction from the reality of visible market transactions. Dwelling units vary in their characteristics (size, number of rooms, age, amenities, location, etc.) and therefore monthly rentals are not prices of homogeneous goods. They represent the costs of different baskets of housing services. In Olsen's (1969, p. 613) words, "In order to view the housing market as one in which a homogeneous commodity is bought and sold, an unobservable theoretical entity called housing service is introduced. Each dwelling (or housing) unit is presumed to yield some quantity of this good during each time period". The definition of a unit of housing service makes no distinction between the quantity and quality of a dwelling unit. It represents the abstraction of that service to which tenants attach value. For example, if one dwelling rents for double the amount of another dwelling in the same market, then we impute to it the production of double the housing services as the first unit.

The intensity of the housing services which a dwelling unit produces defines its quality. The assumptions of perfect information and rational decision making imply that tenants and landlords can calculate the real financial implications of the different actions they could or do take under a particular rent control regime. This means that what matters for landlords is the real rent level they receive and will receive in the future, given alternative actions taken by them. Their choices will be such that they will maximize the present value of the anticipated stream of net income they will receive -- including the ultimate capital value of the property when it is sold.

In an uncontrolled rental housing market landlords can adjust the rent level of a dwelling and/or the quantity of housing services produced by that dwelling (assuming there is no excess supply). A change in the volume of rental services may be obtained by a change in expenditures upon maintenance and repair, or investments in alteration and additions, or a change in expenditure patterns upon various additional services. The landlord may eliminate certain services altogether (e.g., the provison of a heated swimming pool) or reduce their availability or quality, and thereby reduce immediately the quantity of housing services supplied to tenants. Alternatively, the landlord may reduce maintenance expenditures, e.g., repaint the common areas only every five years instead of every three years. It has been suggested that the actual effect in the controlled market in Ontario has been a transfer of responsibility for maintenance. Specifically, it is now generally considered to be the tenant's responsibility to paint his unit. In fact, all responsibility for all non-common, cosmetic maintenance seems to have been transferred from the landlord to the tenant.

In the absence of maintenance the dwelling unit will deteriorate more rapidly over time. This means, in theoretical terms, that the building will produce smaller and smaller quantities of housing services. The rate by which such deterioration will occur will depend on the type of unit construction, its age, etc. The pattern of expenditures will also affect the timing of such deterioration. For example, reduction of expenditure levels upon structural maintenance in a new building may not reduce the quantity of services produced by a unit in a significant way in the short-run. It may, however, result in a more rapid deterioration after a certain period. Expenditures upon cosmetic features, however, may have a direct impact upon the quantity of housing services provided in the short-term.

Most adjustments in the short-run, in response to shifts in demand, are made through price changes, i.e., in the nominal monthly rent. Landlords will also adjust the bundle of services they provide if some bundles become more profitable than others. Thus a shift in the structure of rental housing demand will lead to a gradual shift in the supply of units of the type which is more profitable until a new equilibrium is reached and normal profits accrue on all rental dwellings. In addition to adjustments in the existing stock, new construction will take place as long as returns from rental buildings provide investors with normal rates of return on their capital and entrepreneurship, given the risks involved.

In this framework, it follows that landlords will scan present and future alternative uses for their investments and convert their units when the expected returns on conversion are higher than continuation of the present use.

Tenants, who are also assumed to be rational and to be perfectly informed of all market opportunities, are assumed to choose, given a market price of housing services, a dwelling with a particular bundle of characteristics so as to maximize their utility functions, given their budget constraints. They may choose to satisfy their housing requirements in alternative housing markets if these markets offer them a feasible and more rewarding pattern of consumption, i.e., they make optimal trade-offs by tenure types and by travel time. Thus a change of income or tastes of tenants may result in movement within the market so as to improve the match of dwelling characteristics and tenants' requirements or it may result in a movement outside a particular rental market.

Rent controls affect the behaviour of participants in the rental housing market in a variety of ways depending upon the impact they have on the benefit/costs calculations of tenants and landlords in the market and the constraints they impose on alternatives open to them.

In Framework 1 we can make assumptions about the behaviour of regulators that view their behaviour from a normative perspective and assume that governments will act so as to minimize the welfare losses to society of controls. Thus, the role of regulation will be justified only as a measure to deal with short term market disequlibria, maintain competition, reduce transaction costs, and to provide information (i.e., prevent market failures).

Alternatively, in Framework 1 we can view government actions as political actions designed to obtain/retain political support, notably to win elections. Stigler (1971), for example, developed his demand and supply theory of regulation which views regulation as the result of competition among interest groups seeking regulation so as to maximize their constituency's share in the economic benefits of such regulation. In particular, groups will seek to capture surpluses generated from market operations (i.e., the excess utility generated because all consumers pay a price which is equal to the marginal utility and spend much less than they are willing to pay for the amount consumed if price discrimination was possible and each unit was sold at a price equal to its marginal utility). This type of political behaviour by interest groups is termed "rent-seeking". (More generally, see Hartle, 1984; Stanbury and Thain, 1986.)

It is clear that since rent regulation involves a redistribution of income from one group to another it leads to competition among interest groups for provisions that favour them relative to others. The less entrenched rent regulation is and the more discretion is allowed, the higher will be the benefits and therefore the investment of different groups in lobbying. Becker (1983), for example, considers lobbying costs as an addition to the tax burden and a reduction in subsidies associated with interest group behaviour. In his model the extent of deadweight loss (i.e., loss of welfare to the system as a whole resulting from distortion emanating from the regulation) has an impact upon the relative pressure of those favouring the subsidy and the relative pressure of those paying the subsidy. The model predicts that the greater the distortion through allocative inefficiency that a particular regulation introduces, the less it is likely to be accepted (or retained). This idea suggests, for example, that exemption of new buildings from rent regulation will be retained, while code-compliance regulations* are likely to be eliminated or not enforced.

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* We define code compliance regulations as those requiring landlords to maintain the same level of maintenance after the imposition of controls as before and, in particular, that require landlords to comply with all regulations regarding the habitability of their units.

Becker's analysis also suggests that, since the strength of interest groups will depend in part on the size of their constituencies, the larger the relative share of the renter population the more likely rent regulation is to be maintained and tightened. (We note that in 1975 when controls were implemented in Ontario their strongest advocates lived in the City of Toronto where 69% of households were tenants - see Stanbury & Thain, 1986.) Thus severe rent controls which lead to an eventual shrinkage of the rental stock, have within them the seed of their own self- destruction. In the long run one would expect a return to an unregulated market. This, however, may happen after the virtual "destruction" of the rental market. Alternatively, shrinkage of the rental stock can lead to an aggravated excess demand situation which would perpetuate controls. The question is whether the removal of controls is seen as the solution, or whether alternative measures such as government subsidies are seen as the solution. Assuming that tenants have significant political power, the subsidy approach is likely to be more politically acceptable since then the cost is borne by all taxpayers rather than just by tenants. In addition, subsidies involve transfers from taxpayers to developers of new units only, not transfers from taxpayers to all landlords.

Let us consider the predicted effects of different characteristics of rent regulation within Framework 1.

4.2 Constraints on Rent Increases

Economic analysis within Framework 1 unambiguously predicts that binding constraints on rent levels will lead, ceteris paribus, to a decrease in the quantity of housing services provided in a market. The magnitude of the anticipated reduction of services depends upon the elasticity of the supply function. There will be no effect in the case of completely inelastic supply curve and all rental services will be eliminated in the case of a completely elastic supply curve. The elasticity of supply is dependent to a certain extent upon the particular provisions of the rent control regulations (e.g., the permission to convert to other uses, code compliance features and specification of service and maintenance standards), the time horizon (e.g., in the very long-run supply may be completely elastic), and maintenance and repair technologies.

If rents were frozen at their equilibrium level* there would not be any immediate effect. However, the economic mechanism to deal with an upward shift in demand through price and quantity adjustment (assuming an upwardly sloping supply schedule) is eliminated by such a freeze. If rent levels are controlled in a way that they do not provide for normal rates of return on investment, economic theory predicts that no new construction of rental buildings will take place. To deal with this problem many rent regulation programs exempt new buildings from controls, thus creating a dual market (see Fallis and Smith, 1984b). We shall discuss the consequences of a dual market when we analyze the effects of coverage and exemption rules.

If rents are frozen at their nominal equilibrium level, but inflationary pressures occur in the market, the result will be a gradual reduction in real rents. The assumption of rationality made in Framework 1 means that there is no "money illusion" in economic choices. (Later in our analysis we shall relax this assumption in order to show how in the short-run, behaviour of both tenants and landlords may be affected by changes in nominal values even if real rent values levels do not change.) Because landlords can to a certain extent alter the quantity of housing services supplied by existing units, they will do so. Indeed, ceilings on rent levels can be viewed not as price controls but as expenditure controls (Frankena 1975; Olsen, 1969). Malpezzi (1984b, pp. 5-6) summarizes this comparative static model of rent expenditures control in Figure 4-2 as follows:

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* The concept of the equilibrium level of rent will be used throughout the analysis, hence a brief explanation of the concept may be helpful for non-economists. Equilibrium in a market is said to occur when there are no forces operating that would alter the prevailing price of outputs, inputs and the rate of return on capital. If the rate of return in a market is below that in other markets with equivalent risks, at the margin capital will move toward the market with higher returns. In the long-run equilibrium, the rate of return in all markets will be equalized, given the relative riskiness of investments. We note that the amount of investment that can be expected from a market depends on both market conditions and the existence of rent review, whereas the capital required to enter the market is determined only by the costs of construction. In long-run equilibrium the price of outputs (and inputs) will be such that the quantity demanded will just equal that supplied and there will be no tendency for these prices to change unless some exogenous event occurs.

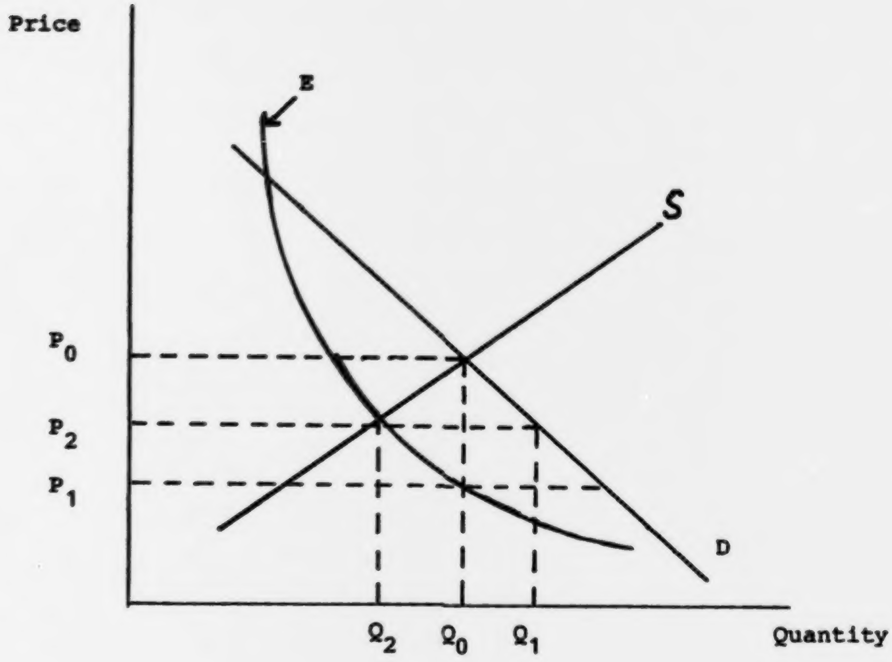
> The imposition of rent control fixes housing expenditures for a unit on or below the rectangular hyperbola E. We consider a single supply schedule with some but not perfect elasticity (S). This is the intermediate run free market supply schedule in the absence of rent control. Suppose that rent control initially lowers real rents to P_1. Landlords have some latitude to vary the quantity of housing services produced by a dwelling over a fairly short period by adjusting maintenance and operating inputs (see Rydell and Neels, 1982). This implies that rent control actually imposes a constraint on the supply curve, now the dog-legged curve SAE, the intermediate run response to rent control by landlords is to move along E from P_1, Q_0 to P_2,Q_2. In the longer run, since price is free to vary (only expenditure is fixed), this simple model implies accelerated depreciation of housing stock, excess demolitions, and reduced operating inputs.

4.2.1 Effects on Maintenance: Moorhouse (1972) examined the dynamic impact of rent controls as expenditure controls assuming a production function with capital inputs, other inputs which must be used at some fixed rates per unit dwelling, and variable maintenance units. A profit maximizing landlord in an inflationary environment with nominal rents frozen is shown to adjust his maintenance expenditures downwards. The time path of real rents declines by the rate of inflation and increases by the rate of depreciation not offset by maintenance. Moorhouse (1972, pp. 45, 96) summarizes:

> In the controlled sector, because the entrepreneur cannot raise his rents in response to increases in demand, he has no incentive to improve the quality of his apartments. Queues form as a result of the increase in demand and allow the entrepreneur to lower the quality of his apartments, thereby lowering costs, without losing tenants ... [Since] increased costs in general cannot be translated into higher rents, efforts to preserve profit levels focus on cost reduction through deferral of maintenance... .

Figure 4-2

Rent Controls as Expenditure Controls



Source: Malpezzi (1984b)

Two main conclusions are derived from the model about the effects of nominal rent ceilings during inflationary times: (i) the economic life of a rental dwelling will be shortened, and (ii) maintenance under rent control will be reduced. The exact level will depend upon the degree to which (i) the burden of maintenance can be shifted to tenants, (ii) the expected penalties both social and legal that are concomitant with low maintenance, (iii) the ability of landlords to reduce operating costs through certain types of maintenance, and (iv) the expected duration of controls, or the impact of maintenance upon the value of the dwelling in alternative uses when and if it is converted.

One alternative which regulators consider a solution to the disinvestment problem is an attempt to develop and enforce a strict code which aims to maintain minimum standards for rental dwellings and services. This is based on the idea that landlords will always try to find some way of "escaping" from rent controls that "bind". Kiefer (1980) investigated the impact of strictly-enforced maintenance provisions in a system of rent regulation with a nominal ceiling upon rents. The dynamic model indicates that one plausible path involves an increase in the rate of demolition of the rental housing stock when higher maintenance standards are enforced. It is also possible that voluntary demolition will occur shortly after controls are imposed if rents are rolled back to levels that provide no net income to landlords. Thus the optimal economic life of a dwelling is reduced by rent controls because (i) the present value of future rents is lowered relative to alternative uses of the dwelling (and its site), and (ii) the reduction in maintenance directly shortens the life of the physical structure of the dwelling unit -- and hence its residual value. (Again the question arises as to which is the cause and which is the effect. Does maintenance reduce the expected life of the building, or does the reduced economic life due to controls result in a different maintenance pattern?)

We note that Rydell and Neels (1982), who studied the Los Angeles housing stock, estimated that without maintenance dwellings would depreciate by eight percent a year thus placing a bound on disinvestment of landlords under controls. As an alternative to rigid maintenance code compliance provisions, cost pass-through provisions are introduced mainly to reduce or eliminate the process of disinvestment.

The decision of a landlord in Framework 1 to invest in maintenance, repairs or renovation depends on the net present value associated with such investments. The model predicts that if the present value of future rent increases and higher residual value of the building exceed the marginal costs of such maintenance or repairs, landlords will make the expenditure. The calculation of net present value will include the present value of (i) the stream of future increases in rents, (ii) the future reductions of costs associated with current maintenance, repair and renovation activities, (iii) the differences in disposal or conversion values when and if the unit will be disposed of, or the value in the end of the planning horizon, and (iv) the stream of direct and indirect costs associated with the investment including normal returns on capital and entrepreneurship.

It is clear that cost pass-through schemes are likely to bring about over or under investment. For example, if the cost pass-through is liberal and consists of all expenses on renovation including financing expenses as well as a provision for return on entrepreneurship and there is no roll-back adjustment when the additional expenses are passed through, then one would expect over-investment in capital improvements. On the other hand, if only a strict selective schedule of expenses is approved for pass-through and no provisions for financing costs and return on invested capital are made in pass-throughs, then one would generally expect under-investment and a reduction in maintenance and repairs.

The specific maintenance, repair service and renovation strategies adopted by landlords will depend to a large extent on the exemption and conversion provisions in the particular scheme of rent regulation since the direct net yields (i.e., the future stream of net rent increases) provide only a partial accounting of the benefits and costs of these strategies. Ceteris paribus, liberal stock conversion rules, sunset provisions, and luxury decontrol provisions, all provide economic incentives for higher maintenance, repair and improvement expenditures. On the other hand, vacancy decontrol provisions may provide negative incentives to spending on maintenance, repair and improvements until the vacancy occurs.

The analysis of effects of automatic rent adjustment provisions is similar to the analysis of a freeze on rents. What matters is the size of the gap between rent levels that would have prevailed in equilibrium (R_e) and the rent levels that are permitted by the control system (R_c). Clearly the gap will be influenced by the general economic environment and the formula for adjusting rents over time. (In Chapter 6 we review estimates of the size of the rent gap in Ontario.)

A fixed rate of adjustment (e.g., 6% per annum) with cyclical inflationary pressures means that the landlord receives varying real rates of increase. Formulae of rent adjustments which are based upon price indexes will have different impacts depending on the relationships of the indexes to underlying economic realities. But what ever the formulae are, as long as controls are binding a gap forms and it becomes incorporated into the decision making in the controlled market. The existence of a rent gap means that periodic adjustments in rent levels are not sufficient to result in equilibrium. Equilibrium, therefore, is obtained by quantity adjustments and by disinvestment (i.e., increase in the real price of housing services by reducing quantities).

When cost pass-through provisions (e.g., through rent review) are combined with the option of automatic rent adjustments, the decisions of landlords become more complex in cyclical economic conditions. They will compare each year which alternative will grant them a stream of incomes with higher net present value and alter their actions accordingly. The existence of choice implies that rent increases will be higher on the average than with automatically prescribed adjustments. The offering of a choice of taking an automatic increase in rent levels or seeking a pass-through of costs via rent review may have an undesirable impact upon the landlord's maintenance and renovation strategies. A landlord may choose to take the automatic rent increase for several years, while deferring maintenance, renovation and repair expenses until the cumulative cost pass-through will be sufficiently large to override the "loss" of the automatic annual increases.

4.2.2 Tenants' Perspective: We have so far ignored tenants' responses in the controlled market. A tenant occupying a rent controlled unit initially enjoys a subsidy -- a transfer of income from the landlord to himself. The subsidy, however, will decline in time if the landlord is able to reduce the bundle of housing services that is produced by the unit through decline in quantity and quality of rental services. Each year the gap will either decrease or increase depending upon the difference between the allowed increase and the change in equilibrium level and on the amount by which the landlord is able to adjust the flow of housing services. In fact, the change in the size of the subsidy probably goes the other way. The subsidy is zero when controls are first imposed and over time the subsidy gradually increases unless rents are rolled back. As the gap increases, however, the landlord is likely to take periodic action to reduce it.

The subsidy and the gradually declining supply of services from the controlled stock means that if the tenant wants to increase his consumption (even at a higher price per unit of service) he may not be able to do so unless he leaves the controlled market and thereby loses the subsidy. The existence of a subsidy, but fewer opportunities within the controlled market to adjust consumption, means lower mobility. The point is that, even for sitting tenants, rent control has some negative consequences -- most of which are not perceived by such tenants until controls have been in place for some time and there is a substantial gap between R_e and R_c. While this point is correct theoretically, mobility rates do not seem to have been significantly affected by rent review in Ontario — see Chapter 6. Although vacancy rates are low, tenant turnover rates remain high; therefore, the adverse impact seems small in the case of Ontario. In other jurisdictions (e.g., New York — see Stegman, 1982) this may not be the case. [We discuss the welfare implications of lower mobility for the tenant and society below.] The subsidy to tenants, however, declines over time if the landlord is able to adjust the quantity of housing services produced by the dwelling and thereby increase the real price of housing services. Arnault (1975, p. 73) following Olsen (1969) analyzes the tenant's gain in utility with the imposition of rent controls in Figures 4-3a and 4-3b as follows:

> In the free market, the tenant demands Q_0 and pays P_0. Total rent paid is P_0MQ_0O. With the imposition of rent control (either an immediate reduction in rents below the free market price or the difference developed over time between competitive and controlled prices), the controlled rent is below the competitive by some percentage a and the total controlled rent paid is $(1-a)P_0NQ_0O$. Thus the rectangle $P_0MN(1-a)P_0$ represents the subsidy from the landlord to the tenant and represents a gain in utility to the tenant (dollars he has to spend on other goods). At this lower real price, the tenant demands a larger quantity of housing than what he actually gets to consume [but, the opportunity of changing apartments in search for more "quantity" is unavailable]. Thus a potential source of utility increase due to rent control is area MNR as the tenant would like to consume more quantity; but this is denied him. [Thus the landlord lets] the apartment (quantity of the services which it emits) decline such that the real price of the unit increases. Adding the long run supply function to figure 4-3 (a) results in the situation illustrated in figure [4-3b]. Obviously P_0 was determined by the intersection of S_{LR} and D in the figure. Since $(1-a)P_0$ is rigid, the owner will let the apart- ment deteriorate until it emits Q_{RC} amount of services

Figure 4 -3a

Imposition of Rent Control and Tenant Utility Gain

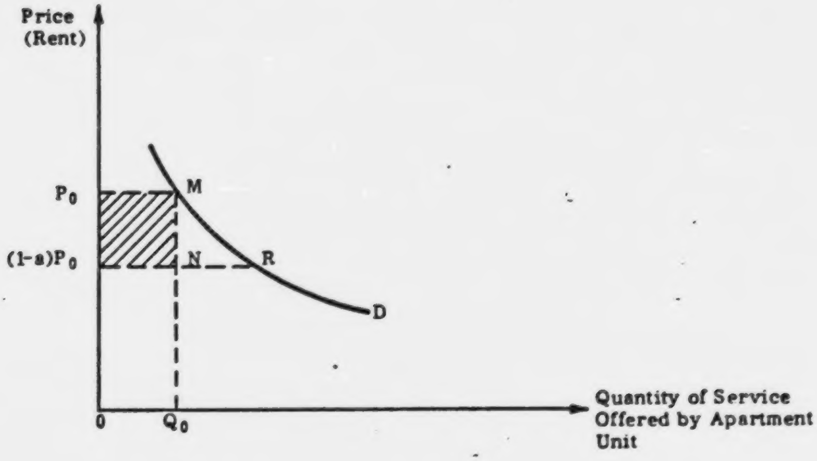
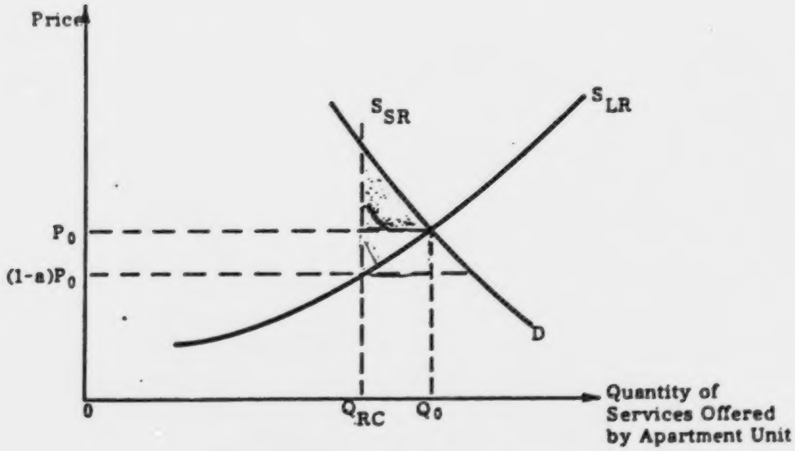

Price
(Rent)
P_0
$(1-a)P_0$
M
N
R
D
0
Q_0
Quantity of Service Offered by Apartment Unit

Figure 4 - 3b

Reduced Quantity of Housing Services Offered with Rent Control and No Minimum Service Constraints


Price
S_{SR}
S_{LR}
P_0
$(1-a)P_0$
D
0
Q_{RC}
Q_0
Quantity of Services Offered by Apartment Unit

Source: Arnault (1975)

> -- the intersection of long-run supply with the fixed price. The vertical lines are the short-run supply schedules. While the initial package Q_0 is deteriorating, it is emitting fewer and fewer services, which can be represented by a movement of the fixed vertical shortrun supply schedule to the left. It shifts inward over time at a speed determined by the rate at which decreases in discretionary costs (maintenance) get translated into decreases in quality, or quantity of services emitted.
> The tenant loses his utility gain (subsidy from landlord) from rent control as quantity of services drops to Q_{RC}. Assuming the tenant's demand has not changed, once the subsidy vanishes, he no longer maximizes his utility by consuming Q_{RC} at price $(1-a)P_0$ and he will move... .

The introduction of an enforced minimum service floor means that the quantity adjustment cannot eliminate completely some form of subsidy, but the tenant may nevertheless move if the utility gained by moving (i.e., the utility loss resulting from undue restriction of consumption) is greater than the utility associated with the subsidy.

Framework 1 provides a stylized, exaggerated view of the lack of opportunities for adjustment within the controlled rental market. For example, Olsen's (1972) assessment assumed decontrol of all units upon vacancy which means that opportunities for mobility within the controlled market, by definition, do not exist. In fact, there are opportunities for adjustment within the controlled market when controls are vested in the unit and not with the sitting tenant. These opportunities, however, are lower since, in the absence of price rationing, other mechanisms of rationing exist (e.g., formation of queues) which involve higher search costs. Thus, while mobility declines it is typically not eliminated in a rent controlled market. (See the discussion in Chapter 6.)

4.2.3 Other Effects: The additional costs of search in controlled markets operate in synergy with the impact of tenure discounts (that exist in most rental markets) upon mobility. (See for example, Clark and Heskin, 1982.)

The effects of binding rent ceilings on the value of the existing stock of rental buildings is unambiguously predicted by Framework 1: binding controls, *ceteris paribus*, mean a lower value. The value is the discounted present value of the future stream of net income (i.e., net income from operations and the residual value upon eventual disposal or conversion). Clearly, reducing one component of net income, namely rents, will reduce that capital value. (The extent of the capitalization effect depends on the efficiency of the capital market.)

The impact upon property taxes depends on the particular tax system. If property taxes are based directly on the market value of rental buildings, since the value of the stock will decline, so will the tax base. This implies a shift of the tax burden from rental housing to the homeownership stock if aggregate tax revenue is to be unchanged.

The effects of rent controls upon ownership housing are more ambiguous. Arnott (1981) and Blatt (1982b) suggest that excess demand in the rent controlled market, in the absence of other types of rentals, may stimulate the demand for homeownership. Indeed, even if a stock of rental housing existed outside controls, rents in it will be higher than those that will prevail in a market in an equilibrium without controls (see Fallis and Smith, 1984b). Thus, the relative attractiveness of homeownership compared to renting in the uncontrolled market will increase. Furthermore, it is argued that the transfer of income that rent controls bring about will mean increased wealth for renters (and decreased wealth for landlords at the time controls were imposed), and a consequent impact upon a switch to homeownership. The tax shift effect will reduce, however, the attractiveness of homeownership. Finally, it should be noted that a system of rent control which tends to equalize rent changes would seriously alter the spatial structure of the city over time.

4.3 Coverage

The unambiguous prediction of Framework 1, that new construction will not take place unless rates of return on investment in the rental housing market are equal to those offered by other investment opportunities, has led the designers of many rent control systems to exempt new buildings from rent controls. Further analysis reveals, however, that such an exemption does not eliminate the impact of controls on the uncontrolled market.

We shall first deal with the short-run impacts of such exemption and the creation of a dual market for rental housing. Marks (1984b) and Fallis and Smith (1984b) have shown that there is a "spill-over" between the two markets and that rents in the uncontrolled market will be higher than those that would have prevailed in the long-term without controls. Furthermore, the quantity produced will also be higher. (The analysis assumes a rising supply schedule and a demand curve which is not infinitely elastic.) Indeed, the larger the uncontrolled sector compared to the controlled, the closer will be the average level of rents in that sector to the equilibrium level. The price will converge upon the equilibrium price as the relative size of the uncontrolled sector increases. The impact of the extent of coverage on rent levels in the uncontrolled market is depicted in Figure 4-4 below.

where,

S = Supply (assuming no change in expectations; this will be captured by a shift in "S" to the right -- hence a lower supply of new units and even higher prices)

D_1 = Original demand function

D_2 = Demand function after a shift in demand

R_e = Equilibrium price without controls when demand shifts from D_1 to D_2

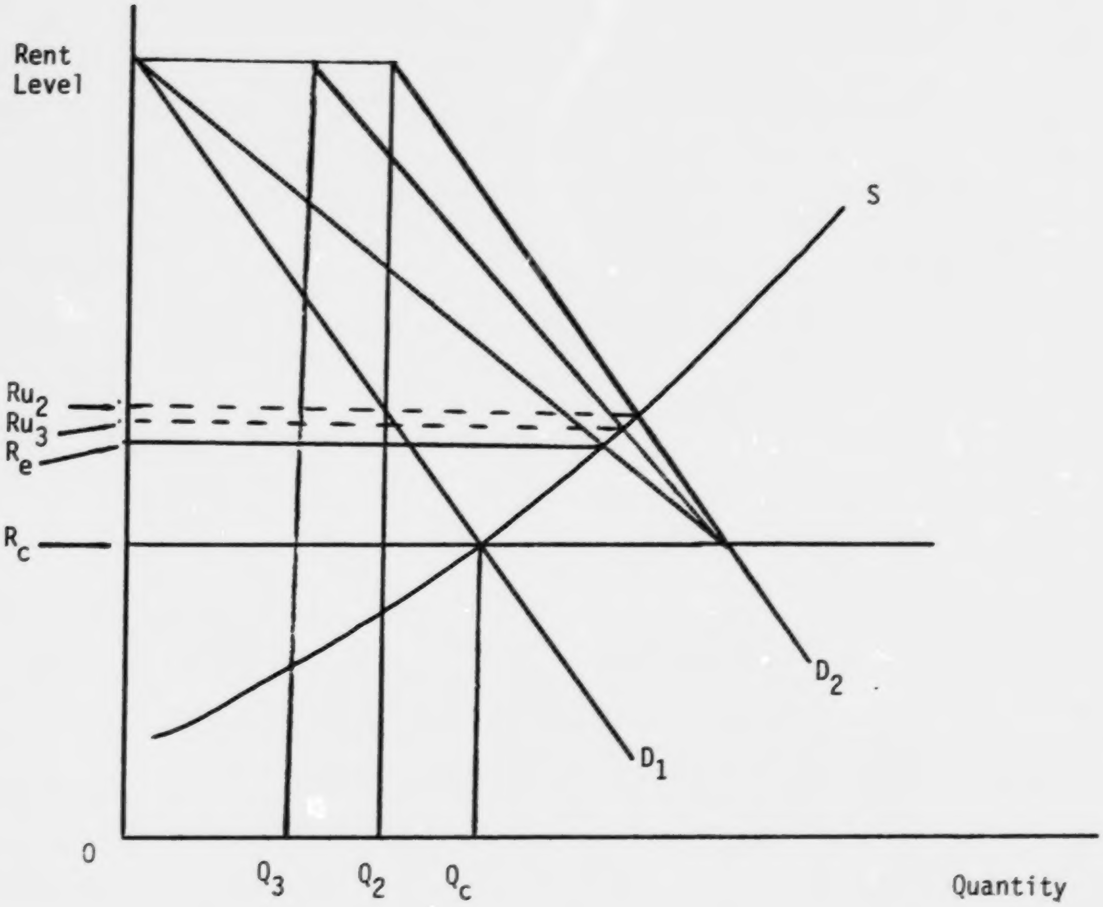
R_{u2} = Rent in the controlled sector when demand has shifted from D_1 to D_2 and $Q_c - Q_2$ is the size of the exempt/uncontrolled sector and the controlled rent is R_c

R_{u3} = Rent in the controlled sector when demand has shifted from D_1 to D_2 and $Q_c - Q_3$ is the size of the exempt/uncontrolled sector and the controlled rent is R_c.

The analysis shows that: $R_c < R_e < R_{u3} < R_{u2}$. These spill-over effects suggest that while rent controls may offer a subsidy to some tenants, they impose costs on other tenants, namely those that live in the uncontrolled sector of the rental market.

If new units are exempted from controls on entry only, i.e., landlords of new units fix the initial rents at what the market will bear, but subsequent

Figure 4 - 4
Rent Controls With An Uncontrolled Sector


Rent Level
Ru$_2$
Ru$_3$
R_e
R_c
S
D_2
D_1
0
Q_3
Q_2
Q_c
Quantity

Source: Adapted from Fallis and Smith (1984b).

adjustments will depend on rent control provisions, the initial rents are likely to be fixed above what they would have been otherwise (even at the expense of a higher vacancy rate) if landlords expect future upward shifts in demand. The inclusion of new buildings under controls will also lead to a shift of the supply function to the left, thus diminishing the quantities offered at any given price level. If new units do not come under the controls for a fixed period of time these will affect the pricing strategies of landlords. This is likely to result in larger rent increases just before controls are imposed than would have otherwise occurred, even at the risks of higher vacancies for some period. (If such movement is widespread, landlords risk a general rollback if controls are imposed.)

Generally, any provisions which imply the eventual decontrol of a unit means that the expected stream of rents will be higher. Therefore, incentives to disinvest will be lower. Similarly, such provisions would have a positive impact upon the supply of new rental buildings.

4.4 Decontrol Provisions

One must consider, however, the perverse effects that such provisions may have in terms of the timing of investment or disinvestment activities.

Rent regulation may include one or several types of mechanisms for decontrolling existing units. While the reasoning for introducing such decontrol mechanisms is varied, many have some common effects. Some of these mechanisms may lead to counter-productive consequences.

The most sweeping decontrol provisions are sunset provisions. Sunset provisions for rent controls are often introduced when rent controls are supposed to deal with what is perceived (or at least stated) to be a temporary crisis. The removal of all rent controls may be unconditional (say a specified date), or subject to a set of conditions (e.g., 5% or higher vacancy rates). Framework 1 does not distinguish between these two types of sunset provisions since perfect information implies no uncertainty about future states of the world. Landlords and tenants are assumed to be able to predict accurately the date and consequences of the removal of controls. Since the unit price of housing services is likely to be higher when controls are lifted, capital values of rental units are also likely to be higher. Maintenance, repair and renovation expenditures are likely to be higher for those activities which prevent irreversible damage or decrease the present value of future operating costs. It is likely that the composition of maintenance and repair expenditures will change in favour of structural repairs since structural damage may lead to irreversible shortening of the economic life of the building. On the other hand, cosmetic maintenance may be deferred with only insignificant penalties.

Clearly, the shorter the horizon of controls the less impact they may have upon decisions by participants in the rental housing market. Given the long lead times of adjustments, controls which are viewed as temporary (say 2 to 3 years) are likely to have only a minimal effect. (Later in our analysis, however, we shall explore the impacts of changes in sunset provisions upon expectations and uncertainties in the market -- factors which are ignored by analysis within Framework 1.)

A popular form of decontrol is the determination of maximum nominal level or levels of rent, for example, by location or number of rooms. Such provisions are introduced to improve the targeting of wealth redistribution embodied in rent controls. Regulations determine what constitutes a "luxury" unit. It is postulated that those who can afford high rents are the wealthy and therefore they are not entitled to the subsidy that rent controls extract from landlords at the time controls were imposed. Such an assumption ignores (i) the fact that in time, with inflation, what was defined historically in nominal terms as luxury is no longer a luxury, and (ii) the fact that low income renters may double-up in more expensive dwellings if they are unable to find a unit in the rent controlled sector. The luxury exemption under inflation creates a form of flow decontrol. Gradually increasing rents mean that all units eventually "float up and out" of controls. While the basic impact of such decontrol mechanisms is the same as the decontrol through sunset provisions, it may lead under certain circumstances to counter-productive maintenance strategies. When landlords are permitted to pass-through increases in maintenance and repair expenditures or renovation expenditures by increasing rent levels, they may consider not only the market benefits of such activities, but also the benefits accruing from more rapid movement toward decontrol of the unit. From a societal point of view, "over-investment" in maintenance and repair could occur.

Another means of decontrol can occur upon vacancy. Two versions can be identified. First, when the unit becomes vacant it is totally removed from the controlled stock. Second, when a unit becomes vacant the landlord may raise the rent as much as he likes, but then subsequent rent increases are subject to rent regulation. The latter version of vacancy decontrol came into effect in New York City in 1971 — see Stegman (1982, pp. 227-228). The rationale for vacancy decontrol stems from the perception that tenant "rights" are acquired through a continuing relationship with a particular landlord (see Knetsch et al., 1984). Thus, a new tenant does not have the same rights as do sitting tenants. What we mean is that a tenant can obtain the rent benefits of controls only by staying in the same unit. Old and new tenants have the same rights in terms of security of tenure, and control over the rate of increase in rents, but the new tenant's rent will be at a higher level than one that continues to live in a similar unit.

Again the basic impact upon long-term behaviour of landlords is similar to the other types of decontrol, except that when vacancy decontrol is introduced the landlord has an incentive to bring about a vacancy as soon as possible. One way of getting a tenant to move is to defer maintenance and repairs as well as by reducing services as much as is feasible. The objective is to increase the real price of the unit as fast as possible until the subsidy accruing from rent controls cannot offset the disutility for the tenant in consuming a much smaller bundle of services than he may desire. Vacancy decontrol may induce landlords even to allow irreversible damage to their buildings when the benefits of decontrol are high enough to offset the costs of such damage (i.e., the gap between rentals in the uncontrolled market and the controlled market is large). In such circumstances cost pass-through provisions may not be effective in keeping up maintenance expenditures. The solution to the problem of ensuring a proper level of maintenace is usually thought to be in a combination of pass-through provisions with strict code compliance regulations.

Allowing tenants and landlords to "contract out"* of rent control (e.g., as the case is in Hong Kong -- see Cheung (1979)) is another means of decontrol. In such a system tenants' rights are capitalized and a competitive market is restored. It is worth noting that the mechanism discussed can only be implemented for units that exist at the time that controls are instituted. The transfer succeeds because most of the value of the unit is tied to a sunk cost which is an immobile physical asset.*

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* "Contracting out" of rent controls means that landlords and tenants in the controlled sector make an agreement whereby the landlord is able to treat the unit as if it is free of controls in the future. This may be done formally where the landlord pays a capital sum for the tenant to move and thereby decontrols the unit. Or it may be done informally, for example, by the tenant agreeing to a higher than legal rent after the landlord extensively remodels the unit. Both approaches are different from the way rent control operates in Quebec, which relies on landlord-tenant contracts. There, landlords and tenants are encouraged to voluntarily agree on rent increases but they are given the "formula" used by the regulator if an agreement is not reached. In effect, private contracting is relied upon and the regulator imposes a solution in the 3% of cases where agreement is not reached. See Stratford (1982, 1985) and Chapter 7.

Contracting out provisions make rent controls a major wealth redistribution mechanism from landlords to sitting tenants. This is especially the case if tenants can sell these rights to other tenants (e.g., by charging "key money"). Landlords would have few incentives to spend any money they are not forced to spend on maintenance or repairs, although they may reach agreements with tenants for tenants to take over such responsibilities.

Rent decontrol provisions have an impact upon tenants' mobility through their effect upon market availability of subsidized units and the impacts decontrol provisions have upon maintenance, repair and renovation. Complete decontrol means that the rent gap (R_e - R_c) will be suddenly closed. If decontrol takes place in a period of high vacancy and slack demand the gap would be smaller and therefore the rise in rents would be moderate following decontrol. Indeed, since the gap between the equilibrium for the whole market in the absence of any controls and the uncontrolled portion of the market (R_u - R_e) also will be closed, it is possible that there will be no change in the average rent, although some will rise and some will fall. Conversely, decontrol implemented after an upward demand shift may result in rapid increases in that portion of the market which was decontrolled, without significant compensating decline in the rents charged in that portion of the market which was not under control.

Elimination or erosion of subsidies to tenants introduced by controls will generally increase the mobility of tenants. Mobility within the controlled market, however, will decline, as the controlled market portion shrinks and offers fewer opportunities for matching bundles of services and tenant preferences. Thus, in a process of gradual decontrol some welfare loss will accrue to the system from declining mobility.

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* It is also interesting to note that the Hong Kong approach could give rise to a type of common property resource problem. If rents in the uncontrolled sector are higher than those in the controlled sector, but they will fall as the controlled sector becomes decontrolled, then it will pay to be one of the first landlords to decontrol. The result may be a competition among landlords to be the first ones to decontrol so that they can capture the benefits most fully.

4.5 Cost Pass-Through Provisions/Hardship Relief

We have already indicated that cost pass-through regulations provide incentives for landlords to maintain, repair or renovate if the undertaking of such expenditures results in a positive net present value of the future stream of revenues and expenses. The calculation of costs and benefits, however, must take into account the impacts of cost pass-throughs upon the future stream of rents (including impacts of decontrol provisions discussed in the preceding section), disposal or conversion values, and the future streams of costs associated with renting, disposing or converting the units.

Hardship relief provisions increase net income and reduce the amount of liquid reserves a landlord needs to keep on hand to deal with economic cycles. If hardship provisions permit a normal rate of return, they will in the long run eliminate the gap (R_e - R_c), thus making rent controls non-binding. (The way such provisions work in Ontario is described in Chapter 5.)

4.6 Security of Tenure Provisions

Security of tenure provisions which ensure orderly transactions in the rental market, denying both landlords and tenants undue power in negotiating rent increases or other conditions of their leases, should have no adverse effect on rental markets. Indeed they may have a positive effect in maintaining market efficiency. For example, regulations can prevent a landlord from arbitrarily evicting tenants who cause no damage, impose no externalities on other renters and pay their rents on time, by charging them more than market rents. Other security of tenure provisions may transfer property rights from landlords to tenants -- see the discussion in Stanbury (1985a, Ch. 4). If such rights expire upon vacancy without compensation, they decrease mobility of tenants and increase the incentives of landlords to disinvest. Similarly, such tenure rights if granted will have adverse effects upon decisions to build new rental housing since the decision to invest will have to consider the capitalized value of the property rights lost by renting. For example, if sitting tenants can prevent conversion of a dwelling into a condominium, the value of the dwelling must reflect the loss of opportunities for potential gains from future conversion. For example, the landlord may consider conversion earlier than planned when a vacancy arises, or he may have to defer the implementation of a decision to convert until a vacancy occurs -- in both cases the timing of conversion may not be optimal. Transfer of certain property rights from landlords to tenants may induce landlords and tenants to engage in strategic behaviour that reduces the allocative efficiency of housing markets.

4.7 Framework 1 Extended: Effects in Segmented Rental Housing Markets

We now explore the implications of market segmentation in rental housing. The price of a unit of housing services in different sub-markets may not be the same since various units of services are not perfect substitutes for each other. However, if one assumes that there is a continuum of sub-markets similar to each other in some respects, then the prices of a unit service cannot vary significantly between different markets.

De Leeuw et al. (1974) summarize the results of a segmented market by means of a price-structure curve — see Figures 4-5 and 4-6. In both, the horizontal axis measures the "quantity of housing services" produced by each dwelling, an index of all of its physical attributes of value. The vertical axis measures the price per unit of services in each of the dwellings.

Generally, prices are bounded from above by the price P_n, the price at which new units are available and below by P_0, the minimal cost per unit of service necessary to keep a dwelling in operation. Units vacant at P_0 for a

Figure 4 - 5

The Structure of Housing Prices

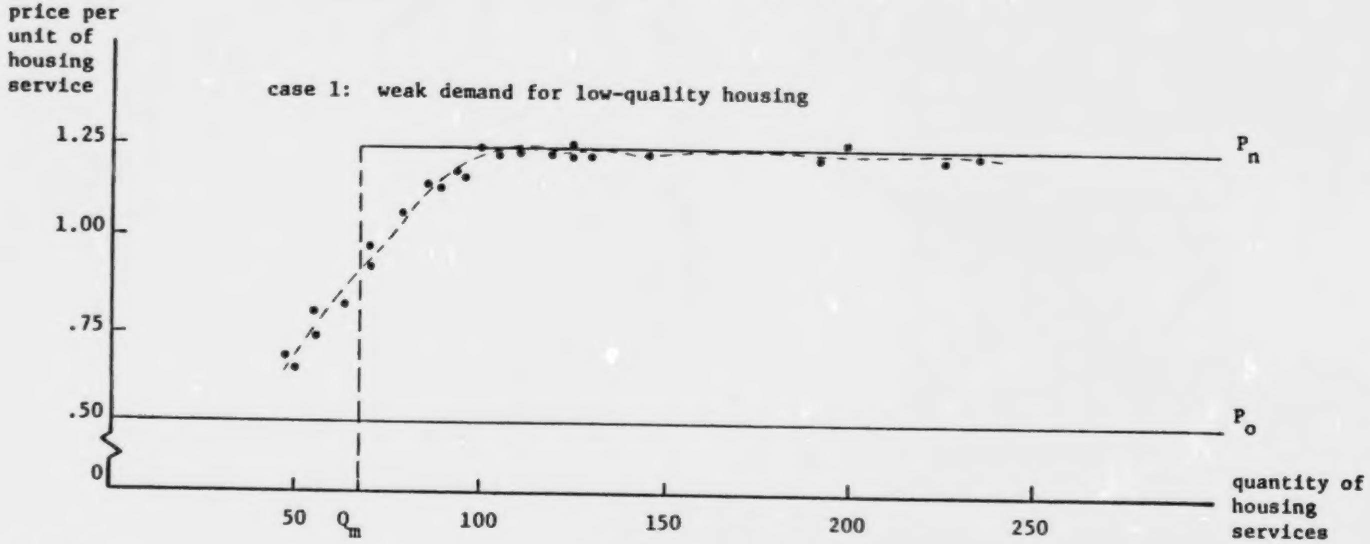
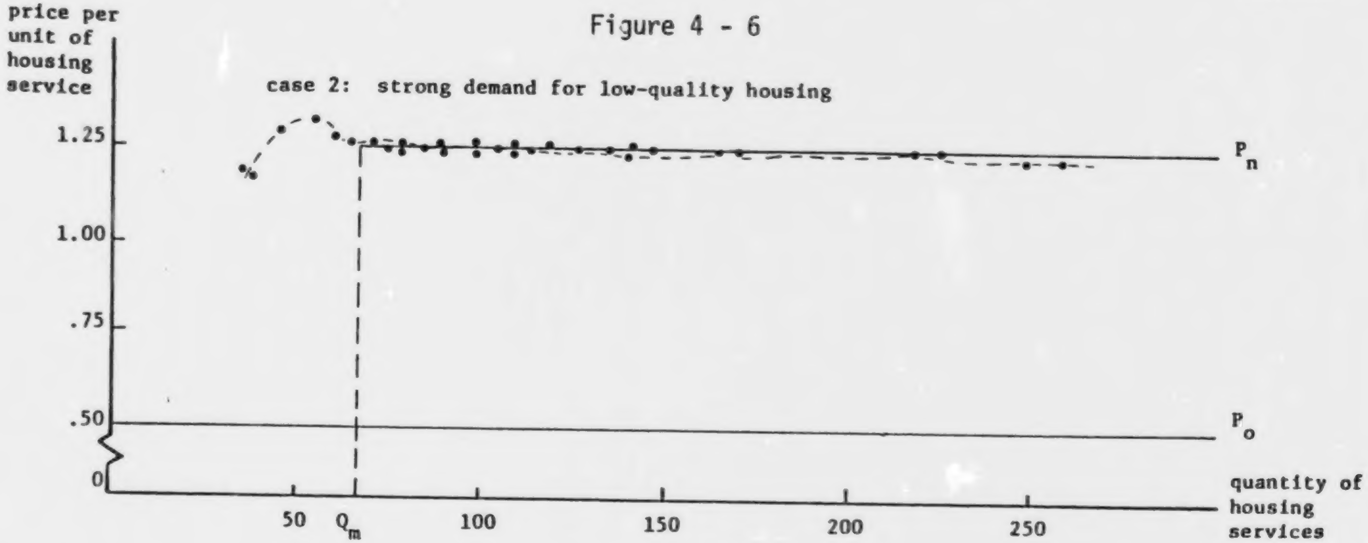


Figure 4 - 6



Source: DeLeeuw et al. (1974).

prolonged time will be withdrawn from the market through conversion, demolition or abandonment.

In the short-run the price of a unit of rental service may exceed the price P_n reflecting a shortage of a certain type of housing (e.g., low quality). In such cases, owners of units in a higher quality or a lower quality segment will have incentive to convert through disinvestment and a reduction in services or capital and non-capital improvements to the segment where demand is strong, reducing the vacancy rate in the segment they abandon. Within the existing stock such adjustments are responsive to changes in tastes, income and other socio-demographic factors which affect the composition of demand for services without affecting necessarily a change in the number of dwellings demanded or even the total quantity of services demanded. Even a change in the number of dwellings demanded can be accommodated, in part, by shifts between market segments, for example, units can be subdivided or enlarged.

Dynamic forces which normally affect the market in the long-run are (i) growth in real income, (ii) growth in population, and (iii) the erosion of the existing stock over time (which can be reversed by investment). De Leeuw (1974, p. 8) states:

> All three of these tend to create excess demand for housing at the high-service end of the range with results that a) prices of existing dwellings in this range tend to be driven toward P_n ceiling and b) new construction tends to take place in this range of services. In the low-service end of the range the three forces do not act in the same directon. Growth in real incomes and depreciation of the housing stock probably tend to create excess supply of dwellings in this range and hence lower prices. Population growth, on the other hand, tends to increase the demand for services in this range, especially when population growth takes the form of an influx of low-income households. Where the excess-supply forces dominate the result may be a situation ... in which low-service dwellings sell at a discount per unit of service. Where population growth is rapid [there may be a case in which] the low-service end of the scale sells at a premium.

In an effectively segmented, rent-controlled market, without cost pass-through provisions sufficiently attractive to stop disinvestment, one would expect a more rapid deterioration in the housing stock in the low- and medium-quality ranges of the market. This is likely to be the case because these segments are typically older and require higher maintenance and repair expenditures to keep their quality constant. The demand pressures in the short-run in the better segments of the market will be high, while vacancies may emerge in the lower quality segments. Higher vacancy rates will decrease profits of landlords faster. This accelerated deterioration, reinforced by neighbourhood effects, may result in a higher rate of conversion and/or abandonment. This may lead in the medium term not only to a higher price per unit of rental service, but also a low vacancy rate in this market segment. The temporary (short-run) abundant supply of low-quality units (at relatively high prices per unit of rental service, but low rents per dwelling unit) may affect the mix of migrants to a particular market. An influx of low-income migrants to the centre of a city may slow the abandonment or conversion process, but change the physical nature of the existing stock. The process of disinvestment will commence in the "higher quality" and newer segments of the market with a lag.

We do not have any evidence of this occurring in any market prior to the actual abandonment of buildings. One may ask why maintenance would deteriorate to the point where vacancies increase significantly? The objective of reduced maintenance is simply to reduce the flow of housing services to the equilibrium level, not to reach the point where units are over-priced given market supply and demand conditions. While we suggest that households will tend to move from the controlled sector to the uncontrolled sector in order to upgrade quality, some observers suggest that households would stay in the low-priced sector where the price relative to quality is low. They argue that the rental sector is largely transient in that the normal household with increasing real income is only there until they can afford to own a home. People are more likely to move into ownership than move into the uncontrolled sector.

The market adjustment process through changes in the quantity and quality of services (rather than change in rent levels) will reinforce the general tendency of households shifting to higher market segments as their income grows over time. As long as there is an uncontrolled, superior segment of the market (the luxury or new building segment), this accelerated shift of demand will lead to higher increases in rents in this sector than would have occurred without rent controls. Thus the dynamics of a segmented market produce a similar spillover effect to the one obtained by considering only two market segments: controlled and uncontrolled (see Smith and Fallis, 1984b; and Marks, 1984b). If inflationary pressures are high and the gap between the prices per unit service in the highest quality segments of the controlled portion of the market and the uncontrolled market become significant in the short-run, the movement of tenants from the controlled to the uncontrolled market will decline leading to high vacancy rates in that market and therefore lower increases in rent.

The decline of tenant mobility will produce the welfare losses described by Olsen (1969). Sitting tenants who would have been willing to consume more housing services at higher prices, decline to do so when the switch involves the complete loss of a significant subsidy afforded them by rent controls. The lower vacancy and mobility within the controlled portion of the market will create further welfare losses. Matching housing service characteristics to renters' preferences (trading one dwelling for another with somewhat different characteristics) will be more difficult and costly. As we noted earlier, the loss of mobility is related more to turnover rates than to vacancy rates. There is no strong evidence that in Ontario rent review has led to much reduction in mobility — see Chapter 6. It may be that mobility in the controlled sector only declines if controlled units comprise a sufficiently small portion of the total market. This requires either localized controls or a large uncontrolled sector. Obviously, the point at which mobility becomes impaired depends on a number of factors including the gap between controlled and uncontrolled rents, the variance in the gap among units, and the size of the controlled portion of the market.

Thus, by creating within the controlled sector discontinuities between different market segments as well as creating a discontinuity between the controlled and uncontrolled markets, rent controls reduce consumption, reduce mobility and reduce the optimal matching of renters and dwellings and hence result in welfare losses (i.e., loss of consumers' surplus).

Earlier we noted that it is important to consider both the direction and the magnitude of effects. This seems to be a good example where magnitudes are important. Specifically, we need to know for the purpose of practical policy analysis how much is consumption reduced, how much is mobility reduced, etc. If the magnitude is not large then the concern may not be significant although the direction of the effect is undesirable. This point also applies to the discussion which follows below.

We note that cost pass-through provisions may offer incentives to stop the disinvestment process. Indeed, if rent increases provide expected normal rates of return on the marginal investment, rational landlords will undertake such investment (abstracting of course some "real world" problems of cash flows and financing). Furthermore, if conversion of the rental stock is permitted, and if maintenance and renovations enhance the value of the stock when it is disposed of, the normal rates of return must take into account the present value of the benefits of maintenance and renovation when the property is sold or converted.

Sufficiently generous pass-through provisions will eliminate both the dichotomization of the controlled market and the trend for downgrading. (Downgrading and upgrading will reflect demand shifts between market segments and landlords' rational adjustments of their stock to these shifts.) To a degree, such provisions may narrow gaps between the high quality segments in the controlled market and the uncontrolled market.

Detailed code compliance regulations in respect to maintenance and the provision of services to tenants may freeze the segmentation of the market and create artificial oversupply and undersupply in specific segments when demands change. Thus these provisions may result in a welfare loss.

The dynamic implications of flow-decontrol provisions in a segmented market are of some interest. These would include such things as vacancy decontrol and exemptions of units whose rents rise to exceed some specified level. If units charging above a certain rent level become decontrolled, and if rents are permitted to rise over time, flow decontrol in a segmented market will aggravate what can be called dichotomization -- that is, a rapid process of disinvestment in the lower quality segments of the market than in the upper segments. Indeed, under reasonable assumptions one can show that cost pass- through provisions will also accelerate the process. Landlords in units close to the exemption limit will have incentives to invest in improving them and maintaining them even when direct net marginal returns on these investments are negative because such increases may lead to earlier decontrol and the expected benefits they imply for the landlord. For the lowest segment of the market (if the limits are sufficiently high), the costs involved in attempting to escape control through the use of cost pass-through provisions may be prohibitive. Therefore, maintenance and renovation decisions will reflect only the the direct net benefits that such activities are expected to generate.

4.8 Application of Framework 1

Framework 1 provides a good approximation for behaviour in the real rental market in (i) stable environments, (ii) where rent controls remain constant, (iii) enforcement is strict but inexpensive (i.e., people obey the regulations without need for strong sanctions and inspection), (iv) where renters and landlords are well informed about the market, the regulation and regulator's future actions, and have specific economic relationships (e.g., impersonal corporate landlords who maximize profits as opposed to occupant landlords of small units who develop personal relationships with tenants), and (v) there are many landlords and tenants, and (vi) the size of the gap is not large.

4.9 Framework 1: Major Implications

4.9.1 Regulators and Political Activity

- From a normative point of view, regulation can be potentially justified as a means for preventing various types of market failure and as a means of smoothing the path of adjustment to equilibrium.

- "Affordability" of rental housing is a policy dimension best defined in terms of income levels and distribution, not rent levels or specific ratios of rent to income.

- Rent regulation involves a redistribution of income from one group to another, thus it leads to competition among interest groups for legal provisions that favour them relative to others.

- The larger the relative share of renters in a population the more likely that rent regulation will be established and continue in existence despite "sunset" provisions.

- All things being equal, the larger the deadweight loss associated with a provision, the smaller will be the lobbying pressure of those who will gain a net benefit from its implementation (Becker, 1983). Provisions such as maintenance codes are likely to be eliminated or not enforced. New buildings exempt from controls are unlikely to be brought under controls in the future.

4.9.2 Characteristics and Effects

- Constraints on rent levels will lead, ceteris paribus, to a decrease in quantity of housing services provided by landlords. The key variable is the gap that rent level ceilings create between the controlled rents (R_c) and the rents that would have prevailed in the long-run equilibrium without rent controls (R_e). The magnitude of the anticipated reduction of services will depend upon the elasticity of the supply function. The elasticity of supply is a function of time, the characteristics of the stock and regulations that seek to prevent a decline in maintenance and repair levels. Thus regulations to ensure a proper level of mantenance and which prohibit or discourage conversion or abandonment will slow the rate at which the quantity of housing services will decrease in the short-run.

- If rates of return on investment are below normal (i.e., opportunity cost), no new construction of rental buildings will take place. Thus to encourage new construction new buildings must be exempted from rent control or provisions must be made to ensure normal returns on invested capital (e.g., subsidies or tax expenditures).

- Controls on rent levels are expenditure controls not price controls. Thus if they are binding on rent increases one would expect that landlords will adjust the real prices of housing services by reducing the quantity of services supplied. (Services and repair and maintenance expenditures will be reduced and upgrading and renovation activities would cease.)

- Rent ceilings during inflationary periods will tend to reduce the economic life of a rental dwelling.

- A strict code aiming to maintain minimum maintenance standards will further reduce the economic life (but not physical life) of the dwelling or will accelerate the rate of conversion, demolition and abandonment.

- Cost pass-through schemes, if they provide normal returns on incremental expenditures, may prevent stock deterioration and lengthen the economic life of the rental dwelling. Because of the irreversible nature of the typical pass-through provisions they are likely to bring about over-investment if they are sufficiently flexible. Inflexible provisions will tend to lead to under-investment.

- All other things being equal, liberal stock conversion rules, sunset provisions, and "luxury" decontrol provide economic incentives for higher maintenance, repair and improvement expenditures. Vacancy decontrol may inhibit these expenditures.

- The benefits of controls accruing to tenants generally decline over time as a result of quantity (and quality) adjustments by landlords. (But if demand exceeds supply over time, then the gap, even on a quality-adjusted basis could increase.)

- The award of non-transferable subsidies to tenants in the form of rent control results in lower mobility and higher deadweight welfare loss to the system. As the subsidies decline mobility will tend to increase.

- The introduction of enforced minimum floors on maintenance and repairs means even lower tenant mobility since some subsidy cannot be eliminated by reducing the quantity of housing services provided.

- The introduction of binding ceilings on rents, ceteris paribus, means the existing rental housing stock will have a lower market value.

- If property taxes are a function of market values, then the tax base will erode with the introduction of rent controls and there will be a shift of the tax burden to the uncontrolled rental housing sector, the homeownership sector, and other property tax payers.

- Rent controls systems tend to equalize the rate of increases in rents. This will alter the spatial structure of a city over time.

- Under a system of controls where new buildings are exempted, rents in the uncontrolled housing market will be higher than those that would have prevailed in long-term equilibrium without controls ($R_u > R_e > R_c$).

- The larger the size of the uncontrolled sector relative to the controlled, the closer will be the average level of rents in the uncontrolled sector to the equilibrium level without controls.

- Vacancy decontrol, ceteris paribus, may lead to strong incentives to reduce the supply of housing services by, for example, reducing maintenance and repairs hence forcing tenants out. Then the landlord can take possession of a decontrolled unit. Pass-through provisions may lose their efficacy when vacancy decontrol is introduced into the statute. Cost pass-through provisions with strict code compliance for maintenance may solve this problem.

- Security of tenure provisions which ensure orderly transactions in the rental market, denying both landlords and tenants undue power in negotiating rent increases or other conditions of their leases, should have no adverse effect on rental markets. Indeed, they may have a positive effect on allocative efficiency.

- Security of tenure provisions which transfer property rights from landlords to tenants and which expire on vacancy reduce mobility. Such tenure rights will shift the supply schedule of new units to the left, since the value of the transfer of rights will be capitalized and reflected in the initial rents charged.

- In an effectively segmented, rent-controlled market, without cost pass-through provisions sufficiently attractive to stop disinvestment, one would expect a more rapid deterioration in the housing stock in the low- and medium-quality ranges of the market (because the excess demand is the greatest in those segments).

- The short-run increased supply of low-quality units (at high real prices) that may result from controls in a segmented market may affect the mix of new entrants to a particular market. A change in the mix of new entrants may further stimulate the process of deterioration in the rental stock, i.e., high quality demanders go to ownership.

- In segmented rental markets, greater discontinuities between different quality segments will emerge as a result of controls. This will result in a decline of mobility between segments in the controlled portion of the market and a decline in economic welfare.

- In segmented markets, sufficiently generous cost pass-through provisions will tend to eliminate these discontinuities and the general trend toward downgrading.
- Strictly enforced detailed code compliance provisions concerning services to tenants and maintenance in a segmented market may freeze the existing pattern of market segments and create oversupply and under supply in specific quality types of rental units when the demand shifts.
- In segmented rental markets, a "luxury" decontrol provision will accelerate the creation of discontinuities in the controlled market. Further acceleration is expected if "luxury" decontrol is accompanied by cost pass-through provisions.

5.0 FRAMEWORK 2

The assumption of perfect information made in Framework 1 does not provide a reasonable portrayal of a market characterized by heterogeneity and which is embedded in a volatile macro-economic environment. Information in such a market is neither perfect nor costless. Imperfect information implies that (i) tenants and landlords face uncertainty and must base their decisions in part upon expectations and estimates, and (ii) rent regulations may not be obeyed in some instances either because of ignorance or because incentives exist to violate certain provisions of those regulations. Framework 2, therefore, focuses upon the analysis of alternative design characteristics in markets where information is imperfect and regulations are implemented with varying degrees of fidelity.

The general analysis focuses upon (i) the impact of uncertainty or imperfect information upon decisions in the rental housing market, (ii) the consequences of high information costs upon market clearing processes and implementation of regulation, and (iii) the evolution of "black markets", illegal markets for rights, and other illegal market-clearing mechanisms.

5.1 Uncertainty and Decision Making in the Rental Housing Market

One can distinguish between the following types of uncertainty which may affect the rental housing market: (i) uncertainty with respect to the future macro social and economic environment, (ii) uncertainty with respect to opportunities in the current rental housing market, and (iii) uncertainty with respect to government intervention in the housing market or related markets -- in particular, government moves to impose, modify or remove specific rent regulations. All things being equal, it is reasonable to assume that a majority of tenants and landlords prefer future choices which are expected to yield them the same amount of benefits, but involve less uncertainty (variability). Indeed, in investment markets investors require and receive premiums above the risk-free interest rate when investment prospects involve uncertainty. The high correlation of return on investment in rental housing with other investment opportunities (many of which are also sensitive to the same macro-economic variables) means that it is difficult to reduce risks by the diversification of the portfolio of investments. Furthermore, the large sums involved in buying rental units and the relative indivisibility of such investments also restrict opportunities for diversification. Assessment of rent controls must therefore consider their impact not only on expected returns and risk levels, but also their impact upon opportunities for risk reduction. For example, regulation which leads to smoothing of the time path of rent increases but does not affect long-term equilibrium rents will reduce risk levels and simultaneously reduce their systematic variation, i.e., the cyclical variation in tandem with other investment markets. (In discussing options for smoothing the time path, it is relevant to consider the symmetry of the proposal. In other words, does it remove high prices in excess demand situations and low prices in excess supply situations? Second, if the time path is smoothed perfectly by overriding disequilibrium prices, then what corrective mechanism will bring supply and demand back into line?)

Uncertainty introduces an important new behavioural dimension into the decision processes in the rental housing market. Investors who make long-term investments must attempt to predict the future states of the market and its external environment. In general, expectations about the future are formed in part on the basis of past experiences. Events in the past are assessed as to their prognostic value, i.e., their relevance to prediction. For example, a change in rent controls introduced by a government in response to what appears to be unique circumstances (e.g., a war) will have a much lower impact upon expectations than the same change introduced before an election, or in response to a regularly re-occurring problem. Real or apparent patterns of behaviour are deduced from repeated actions. For example, the first extension of "temporary" rent controls may revise somewhat the belief of market participants in the predictive validity of a sunset provision. A second or third extension, for most market participants, means permanency of controls irrespective of stated sunset provisions.

Induction from observed patterns for the purpose of prediction is done not only on the basis of sequences of events, but also from patterns of events at a particular point in time. For example, a government which actively intervenes in a variety of economic dimensions is perceived to be more likely to intervene in a particular dimension even if it has not yet done so.

In general, the prognostic values of events depend on their salience, simplicity and recency. Thus, the introduction of complex provisions in rent regulations with important effects may have less effect upon expectations than the introduction of provisions which are rather narrow in application but are simple and highly visible. Similarly, a few highly visible events which suggest that the particular intentions of a regulatory regime are not fulfilled, may provide a signal with a great high impact on the market and on politicians, than routine benign, widespread erosion of the regulatory regime's basic structure. The analysis of the impact of a regulatory regime's characteristics upon expectations (and consequently effects) must therefore consider not only their direct impact but also the impact they have on events they prevent from occurring or events that they promote.

The formation of expectations is based not only on experience but also on calculations. Specific provisions of rent regulation that are entrenched in the law,for example, will be considered more likely to remain unchanged than a provision that depends only on administrative actions. The degree of difficulty and costs of change are considered important factors in assessing the likelihood of such a change. If, for example, the specific level of maximum allowable rent increase is entrenched in the legislation (as is the case in Ontario) and a change in the level of increase requires an amendment, tenants and landlords will tend to assign lower probability that it will be changed, than if it was fixed either by discretion or by a simple formula by the regulators.

Generally, provisions in the legislation which are relatively easy to change create a higher degree of uncertainty than those which require lengthy or costly process of amendment. Similarly, a system whose history is characterized by rapid regulatory change will increase uncertainty unless there is consistency in the direction of change.

5.2 The Impact of Imperfect Information

Arrow (1970) and Williamson (1979) identify imperfect information as one of the most significant sources of transaction costs; more generally, see the discussion in Stanbury (1985b, Ch. 4). (Information can also be considered as a commodity.) Coase (1960) suggested that transaction costs include search cost, the cost of acquiring information about all opportunities for exchange, bargaining and decision costs in making contracts, the cost of monitoring or policing contracts, and the costs of enforcing contracts in the event of violation of their terms. Dahlman (1979, p. 147) concludes that all these categories reduce to one: "resource losses due to lack of information".

Imperfect information about all opportunities for exchange in the rental housing market and about the opportunities or constraints that rent regulation potentially offers or imposes, has several important consequences for the operations of housing markets. First, since economic benefits can accrue from information acquisition activities, both tenants and landlords evaluate the costs and benefits of such activity. Typically there is asymmetry in the position of various actors with respect to information costs due, in part, to the special nature of information. Information acquired for one transaction can be used for another, thus there are economies to scale favouring generally landlords and in particular landlords with large holdings. It is likely, therefore, that landlords will be more informed about rent control regulations than tenants, and generally more informed about market conditions. (Parity may exist in the case of small landlords and their tenants.)

If tenants organize, pool resources and produce information for their members, the asymmetry in the level of information and in the costs of acquiring information may change in their favour. On the other hand, if landlords organize, such organization may enhance the advantage they already have.

Governments are an important potential player in the rental housing market:

- as direct providers of information about rent regulation and the market,
- as enforcers of information disclosure laws in market transactions, and
- as triggers for or stimulators of tenants' organizations and/or landlords' organizations.

Indeed, as we shall argue later, certain provisions of controls (e.g., provisions for rent review of entire buildings) encourage the organization of economies of scale in using information. Some provisions of rent control regimes may directly and explicitly deal with asymmetries in information, requiring, for example, the posting of information so tenants can have access to it, and registering information with the regulator to ensure reliability. Certain provisions of rent control, while not meant to provide market information, are nevertheless perceived by some participants as signals and thereby become market information. For example, the announcement of new rent increase ceilings may be interpreted by tenants as market information (a change in market prices), even when such ceilings are arbitrary and unrelated to the market.

The high costs of moving (for both tenants and landlords) leads to special features in the rental housing market. These include some of the attributes characterizing Williamson's (1979) "economics of idiosyncrasy" (see Stanbury (1985b, Ch. 4) for more details):

(i) A continuous relationship between buyers and sellers, with the passage of time, may produce economies of communication and of adaptation to each other's needs as "both institutional and personal trust relations evolve". The possibilities of opportunistic behaviour are often eschewed when the benefits of a good working relationship are apparent to the individuals directly involved.

(ii) The assurance of a continuing relationship is needed to encourage specialized investments, but it is virtually impossible to specify in a long-term contract all contingencies and the appropriate responses to them. "Intertemporal efficiency nevertheless requires that adaptations to changing market circumstances be made" (Williamson, 1979, p. 241). Both parties, however, face incentives and hazards of opportunism. (Opportunism involves the strategic manipulation of information or misrepresentation of intentions.) The consequence of these characteristics in the rental housing market is the phenomenon of "tenure discounts" and what appears to be a smoother process of adjustment of rents even in the absence of controls. Some characteristics of rent regulation may prevent such mutually advantageous adaptation (e.g., specialized investments that meet the need of a specific tenant), and provide incentives for opportunistic behaviour, while others may inhibit such behaviour. The existence of the idiosyncratic economy implies also that it is likely (especially in relationships between sitting tenants and small landlords) that rent regulations will be ignored and arrangements will take place between tenants and landlords outside the law. Such arrangements are different from the ones in black markets which reflect sellers' market power created by shortages, rather than an arrangement which may result indeed in lower increases than the regulation permits. It should be noted that upon a vacancy, the "discount" that landlords give sitting tenants are eliminated and landlords will adjust rents to close the rent gap. In such cases large rent increases will face the new tenants who may find it difficult to enforce the regulation especially if a rent registry does not exist. A new tenant may also be willing to accept higher rents when adjustments in dwelling attributes are promised so as to improve the match of attributes to his preferences.

5.3 The Evolution of Black Markets and Other Illegal Market-Clearing Processes

When controls limit the price of a good below that which clears the market there are strong incentives for illegal behaviour (or other forms of non-price rationing). (Convergence does not necessarily occur, particularly if minimum maintenance standards are enforced.) Circumvention of controls or black markets can take many forms. Indeed, in Framework 1 we have discussed the change of price per unit of housing service by quality and quantity adjustments. Other means of circumventing controls include tying rentals to the purchase of certain services which are not controlled (e.g., renting furniture at arbitrary prices), and a variety of "under the table" payments. The extent and impact of black markets depends, in part, upon the formal penalty structure for different violations, the "social penalty" (loss of reputation) and the intensity of enforcement activity (Browning and Culberston, 1979).

In principle, if regulations are unambiguous, then high penalties and extensive enforcement effort may eliminate all incentives to circumvent regulation. The choice the landlord has is between the certainty of a lower stream of payments versus a gamble consisting of winning a higher stream of payments than permitted by law or receiving this stream of payments less penalties and any retroactive adjustments made for past rents if caught and prosecuted successfully. The probability of receiving one prospective stream of payments or the other depends on the effectiveness of enforcement. The decision to obey the law or circumvent it depends upon the risk taking attitude of the landlord, the outcomes involved, and their probabilities. The intensity of enforcement will depend on both actions initiated by the government and actions taken by the tenant. The tenant makes his decision whether to complain and actively enforce the law by comparing (i) the transaction costs involved (including information gathering costs) and (ii) the costs of retaliatory actions by the landlord with the expected benefits of such a course of action. Retaliatory costs may be high if idiosyncratic economic relations developed in the past and the recourse to rent control enforcement is perceived by the landlord as an opportunistic move. Expected benefits will be higher, *ceteris paribus*, for a sitting tenant with a long expected tenure. High mobility tenants will have few incentives to incur costs in rent control enforcement. Expected benefits will be higher the larger the magnitude of the illegal increase. Landlords, in turn, depending on their assessment of the tenant, will adjust their rent increases to a level just below the one which is likely to mobilize the tenant. Thus black market rents will tend to be higher for mobile tenants and for less informed tenants. Mobile tenants will accrue lower net benefits from enforcing the regulations since the costs of enforcement will have to be amortized over a shorter period of time. The less informed tenants face much higher transaction costs involved in enforcement since they have lower skills and must invest in acquiring the necessary information.

In the absence of tenant associations, landlords of large buildings in black markets could have adavantages over landlords with small buildings (who account for about one-third of the market) emanating from economies to scale and risk-spreading. However, the fact that government enforcement activities are likely to be targetted on landlords with large buildings for obvious reasons, and the fact that publicized complaints may lead to the organization of tenants, more than offset these disadvantages. Furthermore, economies of scale also encourage landlords with large holdings to utilize the regulatory machinery to obtain all of the benefits that can be obtained under the control regime.

When a rent regulation system provides a relatively high protection to sitting tenants, key money, or lump-sum payment at the time of occupancy, are common adjustment mechanisms (Malpezzi, 1984a, 1984b). Such payment systems work to capitalize the differences between the quality-adjusted market value of the unit in the uncontrolled segment, and the controlled price less the costs of inconvenience and risks involved for the tenant in financing the transaction. The horizon for capitalization is the expected length of tenure or the duration of rent controls, whichever is shorter. Such capitalization will take account of the expected deterioration of the dwelling as a result of the expected disinvestment activities by the landlord. A black market for subletting (i.e., a market for tenant rights) may also emerge. If subletting without landlord's permission is prohibited in the regulations, the disinvestment process will be reversed upon the turnover of tenants. The landlord will have incentives to improve the dwelling and will be able to capture his investment by charging key money. The key money will reflect the present value of the difference between the price per unit service in the improved dwelling under control and similar units in the uncontrolled market. If tenant rights are preserved on turnover, no such incentive exists and one would expect the eventual dissipation of key money when the real price per unit of service provided by the dwelling converges to the price level in the uncontrolled market.

An alternative to adjustment through key money is an adjustment of the rent upon vacancy. This option for circumventing rent controls will be favoured in high-turnover rental housing markets where renters will resist making high risk investments in key money. This option involves fewer risks for the landlord when a rent registry does not exist and the probability of a new renter successfully enforcing a rent reduction retroactively is not high. Landlords will have strong incentives under such a system to encourage mobility by reducing the quality and quantity of services between vacancies and upgrading the dwelling and initial services upon vacancy and rent readjustment.

5.4 Analysis of Effects

Framework 2 provides some general predictions with respect to rent controls. Rent controls that contain provisions which are considered severe (as opposed to ones designed to have only a moderating impact upon short-term market transactions) and are perceived to be entrenched for the long-term rather than a temporary response to a crisis, will bring about incentives to circumvent the regulations. All things being equal, the following propositions are implied by Framework 2:

(i) the larger the rent gap $R_u - R_c$, the higher the incentives in the market to circumvent the regulations;

(ii) the higher the transactions costs (including information, search and processing costs) the higher the propensity of participants to reach agreements outside the control system;

(iii) the higher the expected penalties for circumventing controls (i.e., the chance of being caught, convicted and penalized multiplied by the average penalty for such offences), the lower will be the propensity to disobey controls.

If one considers the high costs of enforcement and the moderate penalties which typically apply in most rent control schemes, one is led to the conclusion that circumvention of controls is likely to occur especially (i) in small buildings where tenants are unorganized, and (ii) in market segments which experience high levels of mobility. In these areas the option of circumventing controls serves to reduce some of their impact, but does not necessarily eliminate them completely. Thus an analysis within Framework 2 predicts moderation of all effects of controls predicted by Framework 1 in the two areas referred to. The viable option to circumvent controls, if the rent gap increases beyond a certain tolerable level, means also a reduction of uncertainty for landlords and developers that currently conform to the regulation, and thus reduce the risk premium they require in making investments.

From both a political and normative, utilitarian point of view (that is, a view primarily concerned with efficiency), the mechanisms which emerge to circumvent controls have some attractive features. They reduce welfare losses brought about by controls and reintroduce market processes thereby reducing the misallocation attributable to a more binding system of controls. This will be especially true if the circumvention of controls is intended to preserve the mutually beneficial, idiosyncratic economic relationships between sitting tenants and small landlords. Black markets, however (apart from moral and ideological questions), may during temporary shortages, eliminate all of the benefits of regulation.

The problem of separating true black markets from idiosyncratic economic relationships, that is, preserving the benefits of flexibility without the complete erosion of controls, can be solved by an effective reactive enforcement system triggered by tenant complaints. An effective system of enforcement implies low transaction costs and adequate power to bring about compliance. Such a system provides, in a sense, an informal, inexpensive system for individuals to contract out of controls without incurring high transaction costs. Such an enforcement system is much less expensive than an active enforcement system which seeks to bring about conformity as a matter of principle. The major deficiency of such "lax" enforcement is that information about regulation and enforcement possibilities are unequally distributed. Often those who need the most protection are also the ones with the least information at hand. Targetted enforcement efforts in some market segments may reduce the political costs of allowing circumvention of controls and the emergence of uninhibited gouging in periods of excess demand.

Thus we add a proposition with respect to the dynamics of the system. It is that active efforts to enforce rent controls will be maintained at moderate levels. Enforcement efforts will tend to be reactive, triggered by tenant complaints.

To conclude, the emergence of illegal market clearing mechanisms implies that an alternative to disinvestment and quantity adjustments is open to landlords. Thus, the negative effects of regulating rent levels on maintenance and the supply of new buildings are reduced. The specific incentives offered by generous cost pass-through provisions will lose some of their attraction. Similarly, since black markets reduce or eliminate subsidies to renters, they will increase mobility and reduce the amount of spill-over into the uncontrolled market. (Note that black markets can be viewed as increases in the size of the exempt sector which we presented in our analysis of dual markets in Framework 1.)

The effects of imperfect information and transaction costs on the segment of the market in compliance with the regulation are now analyzed.

5.5 Constraints on Rent Increases

As in Framework 1 we assume landlords maximize profits. However, in Framework 2 we add several new dimensions to the choice process: (i) uncertainty, (ii) expectations and estimates rather than perfect knowledge as the basis for calculations, and (iii) transaction costs. The analysis in Framework 1 focused only on the direct impact a constraint on adjustments in rent will have on the stream of future net income. In Framework 2 we must consider the effect of the constraint not only on the actual flow of net income but also on its variability, and on expectations. Indeed, two alternative formulae which yield identical streams of net profit ex post may have considerably different short- and medium-term effects. Generally, formulae for determining constraints on rent increases which are adaptive to actual macro-economic and market environments will tend to reduce the variability of rates of return, that is, reduce risks and facilitate portfolio diversification. The more the formula for maximum rent increases is synchronized with market realities and individual landlord's cost structures, the lower the level of risk. The lower the level of risk, the lower the negative effect rent controls will have upon supply of housing services in the form of reduction in new construction, maintenance, repair and services and increases in conversion and disposal. Where maximum allowed rent increases are fixed and entrenched through legislation, risks will increase, especially in a market environment which experiences variability in costs. An arbitrary discretionary rate of increase determined politically by an elected body subject to the vagaries of a politically unstable constituency initially brings about a high level of risk. However, in time, if a stable pattern of association between the rates and market conditions is visible the risk level will decline. The risk associated with discretion and flexibility is a function of the way rent controls are administered and the ease and frequency with which the maximum allowable increase in rent are reviewed.

Typically, an independent regulatory body with judicialized standard operating procedures will reduce uncertainty. In contrast, decisions made by bureaucracies are less predictable since they may involve an uneasy balancing act between professional judgments, political expediency and bureaucratic momentum. An elected regulatory body may reduce the risks when clear and stable majorities emerge, supporting one pattern or another of the distribution of the benefits of controls. The lower risk, however, may be accompanied by a significantly lower expectations of benefits to those represented by the minority on the regulatory body.

The calculation of economic net benefits will be based on expectations with respect to the external environment and the control system. Thus if controls are expected to be lifted, their impact will be smaller. An expectation with respect to tightening controls will intensify the effects identified in our analysis of effects using Framework 1.

Finally, landlords' calculations will include the transaction costs associated with controls. This will generally imply a shift of the supply curve to the left, thereby reducing the quantity of housing services offered at each price level. This is in addition to the quantity adjustment that is necessary to bring about a market equilibrium in the controlled market. High transaction costs may also have a direct impact on the effective maximum rent which can be charged. While formally a landlord or a tenant can obtain an individual adjustment, if the process of obtaining such adjustments is prohibitively expensive, they may never employ the option. Thus the option for higher adjustments has no effect on their calculations and decisions.

Asymmetry in transaction costs between tenants and landlords and among different types of landlords, also affect the distributive impact of controls. If tenants face high transaction costs in objecting to rent increases, they are less likely to use the regulatory system to prevent such increases. Similarly, because of economies of scale in dealing with rent review, owners of small buildings are less likely to use provisions for individual rent review even if they could bring about a higher rent adjustment. This means that they will experience much higher risks and lower expected returns than will landlords with large holdings.

Imperfect information affects the time lags with respect to investment, maintenance and repair decisions. When landlords make decisions under perfect information they consider the future stream of revenues and costs. In the case of imperfect information these decisions are made on the basis of forecasts. Forecasts are often based on projections of past rates of change and trends. Typically such projections fail to recognize structural changes in the economy, for example, moving from an inflationary period to deflationary period. Thus in an unregulated market when significant structural changes occur the lag in market expectations results in over- or under-investment.

Rent increase ceilings tend to dampen the magnitude of such fluctuations near the point of structural shift by inhibiting investment during periods of high demand. The magnitude of the counter-cyclical impact of controls on investment depends on the type of rent adjustment mechanism in place. For example, fixed, maximum, allowed percentage increases provide a very effective means for stabilizing investment patterns in the housing market.

Generally, capital values of rental housing are sensitive to risk, thus prices of rental housing will reflect the particular impact of the formula for rent adjustment and the stability and predictability of its application upon the level of risk. The higher the risk the lower the prices. Risk reduction affects positively the price of rental housing in the regulated stock.

5.6 Coverage

The analysis of dual rental market under controls and spillover from the controlled to the uncontrolled market resulting in $R_u > R_e > R_c$ is esentially the same in Framework 2 as in Framework 1 but takes into account a possible shift due to uncertainty in the supply schedule of new buildings even though they are exempted from controls. As Fallis (1984, p. 19) notes: "The risk of subsequent control means that a higher rate of return is needed to attract capital into the industry". Smith and Tomlinson (1981, p. 97) reinforce this point, claiming that "by creating the expectation that capital appreciation component might be lost or reduced by the extension of controls, rent control necessitates a much larger net cash flow and hence much higher rent to justify new construction". Thus, to the effect of a spill-over one must add (i) the shift of the supply curve to the left leading to a higher price in the uncontrolled market, and (ii) a reduction of quantity which may offset in part the increase in quantity brought about as a consequence of the spill-over effect discussed in Framework 1.

The analysis with respect to the impact of other mechanisms of decontrol must also take account of the impact of expectations and uncertainty with respect to tightening controls and the possible reversal of moves toward decontrol. A past experience in modifying or eliminating exemptions will reduce significantly their positive effect in moderating the impact of controls. One must also consider the uncertainties embedded in a decontrol statute. For example, a sunset provision with a specific date involves less uncertainty than a sunset provision triggered by a variable condition (e.g., greater than 5% vacancy rate).

5.7 Cost Pass-Through and Hardship Relief Provisions

We need to modify the analysis of effects of cost pass-through provisions conducted within Framework 1 to account for the presence of uncertainty. Cost pass-through provisions reduce risk by providing a method of adjusting to variations in the economic environment, e.g., a sharp increase in energy prices.

Uncertainty reduces the incentive to strategically defer increases in expenditures and to spend in large lumps when there is an option between automatic general increases and a periodic cost pass-through of expenditures.

Since there is the risk that pass-through regulations would be tightened in the future, the attractiveness of deferral is diminished.

Hardship relief provisions, if sufficiently generous, may play a significant role in removing the most threatening type of risk -- the risk of insolvency. This would relieve somewhat the negative effects of rent controls on the supply of housing services.

High transaction costs in securing rent increases from pass-through and hardship relief provisions will reduce their positive effect. Since transaction costs reflect economies to scale in information acquisition and processing and the use of expertise, landlords with large holdings are more likely to use these provisions than small landlords. Indeed, where arrangements outside the law between tenants and landlords do not take place, landlords with smaller holdings will be more likely to reduce maintenance and repair expenses and respond less to the cost pass-through provisions.

5.8 Security of Tenure

The importance of security of tenure provisions which specify notice requirements assume special significance in the context of Framework 2. The analysis within Framework 1 assumed that tenants know all their current and future opportunities for changing their rental housing services consumption (i.e., moving). Thus, notice requirements did not impose any costs. In the case of imperfect information, as vacancies and turn-over are reduced by controls, the search process becomes more expensive and risky. Tenants who give notice may find themselves without any suitable choices within the controlled market (but see Chapter 6). Tenants, therefore, may first find a new dwelling and then give notice, hence taking a risk of paying rent on two dwellings for the notice period. These expected expenses are additional transaction costs in making the decision to move. Thus, imperfect information implies lower mobility. The longer the period of notice tenants must give to their landlord, the lower the mobility.

5.9 Application of Framework 2

Framework 2 modifies the predictions of Framework 1, taking account of uncertainty, transaction costs and the possible emergence of illegal market mechanisms. It provides, therefore, a more accurate approximation of the behaviour of participants in large, heterogeneous rental housing markets which are subject to a cyclical macro-economic environment.

5.10 Framework 2: Major Implications

5.10.1 Regulators and Political Activity

- Governments are important potential players in the rental housing market: as direct providers of information about rent regulation and market conditions; as enforcers of information disclosure laws concerning market transactions; and because they stimulate the creation of tenants' organizations and/or landlords' organizations.
- Since there are economies of scale in transactions with the regulatory machinery, tenants and landlords have incentives to organize into larger groups. The extent of organizing activities will depend on the costs of organizing. These may vary significantly between different sectors of the rental market. Landlords with small holdings and tenants in small complexes are less likely to organize and enjoy the economies of scale involved in dealing with the regulatory authority.
- Simple visible changes in control regulations may have far more impact on expectations and political responses of interest groups than complex technical changes even when the latter have more significant direct impacts. This fact provides regulators with the means of achieving certain modifications in a system of controls without affecting the vote maximizing calculus or triggering lobbying activities. The converse is also true: the astute manipulation of symbole may have far-reaching political consequences.

- Strict enforcement of the regulations is expensive (and not always effective) and may lead to the elimination of certain social benefits associated with illegal market adjustments. Thus those in charge of the rent regulation machinery are likely to prefer a passive enforcement program, one that reacts to tenants' complaints rather than actively pursuing violators of rent controls.

- Transaction costs for users are an effective means to constrain the opportunities afforded to different groups in the rental market to use the rent control machinery to their benefit (e.g., prohibitive transaction costs for using a certain provision in effect nullify it).

5.10.1 Effects

- The announcement of new ceilings on rent increases may be interpreted by tenants as market information (i.e., a change in market prices), even when such ceilings are arbitrary and unrelated to market conditions. Thus, announcements may have a more pronounced impact in reducing variations in rent increases (i.e., equalization) among units than in reducing the average rent increase in the market.

- The "economics of idiosyncrasy" (Williamson, 1979) that often characterize relationships between landlords with small holdings (who often occupy a unit within their building) and long term tenants imply: (i) large discounts for long-term tenants, thus lower mobility, (ii) more stable rates of rent increases that are consistent with long-run market conditions and insensitive to temporary shortages, and (iii) a tendency to "contract out" of or ignore rent regulations.[1]

- When controls limit the price of rental services significantly below the market clearing level there will be strong incentives to "get around" the controls. Alternatively, possibly illegal means of circumventing controls may include tying rentals to the purchase of certain services which are not controlled, and a variety of "under the table" payments. The extent and impact of "black" markets depend, in part, upon the formal penalty structure, the "social penalties" involved, and the intensity of official enforcement activity.

- The inclination of tenants to "help" enforce rent regulations depends in part on the transaction costs involved, including information gathering costs. Thus, a system which provides informal channels for complaint, easy access to information, and quick responses by regulators would stimulate a higher degree of tenant participation in enforcing rent controls. Similarly, the emergence of tenant organizations (another means for transaction cost reduction) will be accompanied by a higher degree of tenant efforts to enforce rent regulation.

- Mobile tenants will have few incentives to incur the costs associated with enforcing controls. Thus, they will be more likely to participate in black market transactions. Similarly, less informed tenants (often the poor and the elderly) are more vulnerable to illegal demands by landlords or to the failure to disclose material information.

- Economies of scale encourage large, corporate landlords to utilize the regulatory machinery to obtain all of the possible benefits that can be obtained under the control regime. Medium-sized corporate landlords and individual landlords dealing with a relatively mobile renters will have a greater incentive to conduct transactions outside the law.

- When a rent regulation system provides relatively high protection to sitting tenants, "key money", or lump-sum payment at the time of occupancy, are common mechanisms of closing the rent gap. A black market for subletting may also emerge.

- Key money encourages upgrading of a unit upon vacancy and the reduction of services and maintenance after renting to shorten the expected tenure of a tenant and the extent to which controls bind.

- A common black market mechanism in a market characterized by a mobile renter population is informal temporary vacancy decontrol. The rent gap is closed or reduced upon vacancy. In the absence of a rent registry there is little to prevent such market adjustments.

- The larger the rent gap, $R_e - R_c$, the greater the incentive to circumvent rent regulations.
- The higher the transaction costs associated with controls, the greater the propensity of participants to reach agreements outside the control system.[2]
- Black markets and "idiosyncratic economic relations", ceteris paribus, reduce the allocative impact of rent controls. The reintroduction of market mechanisms to limit the rent gap reduces deadweight welfare losses brought about by controls.
- Black markets may eliminate all of the benefits of rent regulation, i.e., the ability of controls to hold rents below the market clearing level.[3]
- The problem of separating true black markets from idiosyncratic economic relationships, that is, preserving the benefits of flexibility without the complete erosion of controls, can be solved largely by an effective, reactive system of enforcement triggered by tenant complaints.
- Active enforcement by the regulator (especially when the rent gap $R_e - R_c$ is large) is expensive and may be ineffective. Regulators and politicians are likely to favour a passive-reactive enforcement which is less expensive. An added benefit of passive-reactive enforcement is the preservation of idiosyncratic economic relationships which, although outside the law, are of mutual benefit to tenants and their landlords, most of whom are small-scale operators.[4]
- When rent controls operate with complete fidelity to the rules, the following will hold:

-- Formulae for determining rent ceilings which are adaptive to actual macro-economic and market environments will tend to reduce the variability of rates of returns, that is, reduce risks to landlords.

-- The lower the level of risk, ceteris paribus, the lower the levels of expected rates of return which must be provided by the regulator to stop disinvestment activities and to promote investment in the sector.

-- Provisions of rent regulation that are entrenched in the law will be considered less likely to be changed than provisions that depend only on administrative actions. Generally, rules that are relatively easy to change create a higher degree of uncertainty than those which require lengthy or costly processes of admendment.

-- Risk is also associated with a high degree of discretion given to regulators. Consistent patterns of regulatory responses, professionalization of the staff, and judicialization of the regulatory process, reduce risk. We note, however, that thereduction of risk does not necessarily mean an improvement from the point of view of landlords. An elected regulatory board with a stable majority of tenant representatives may be consistent in their efforts to tighten regulation, thus the risk is eliminated but the average rate of return will be low; this will not encourage investment.

-- The landlord's supply curve will shift to the left when controls are introduced to reflect the added transaction costs.

-- High transaction costs may reduce the net benefits of many provisons in the system of regulation (e.g., pass-through of increased costs), and thus reduce their impact.

-- Because of economies of scale in dealing with rent review, landlords of small buildings are less likely to use provisions for individual rent review even if they could bring about a higher rent adjustment. Therefore, when landlords with small holdings do go to "individual" rent review they are likely to demand (and get) higher rent increases on the average than landlords with larger holdings.

-- Tenants who face high transaction costs are less likely to use the regulatory system to prevent or reduce the size of rent increases.

- -- Ceilings on rent increases tend to dampen the magnitude of investment fluctuations in a cyclical economy. The magnitude of the counter-cyclical impact of controls on investment depends on the type of rent adjustment mechanism in place. For example, a fixed ceiling on the rate of rent increases may provide an effective means for stabilizing investment patterns. During periods of inflation, for example, the lower rates of return from operation will be compensated to a degree by higher yields from the anticipated appreciation of the building.
- -- Capital values of rental housing are sensitive to risk, thus prices of rental housing will reflect the particular impact of the rent adjustment formula upon uncertainty. They also will reflect the uncertainty involved in the possibilities of changes in the formula.
- -- The risks of extending controls to the uncontrolled market are reflected in higher expected rates of return which are required to attract capital to that rental market.
- -- Cost pass-through provisions generally reduce risk by providing a method of compensating for variations in the economic environment.
- -- Notice requirements imposed on tenants reduce mobility. The longer period of notice tenants must give their landlords, the lower mobility is likely to be, *ceteris paribus*.

6.0 FRAMEWORK 3: BEHAVIOURAL PATTERNS

6.1 Landlords' and Tenants' Behaviour

In Framework 2 we relaxed the assumption of perfect information underlying the traditional economic model, but maintained the assumptions of error free calculations and selfishness of participants. Simon (1955, 1956, 1957), for example, has long recognized that the capacity of individuals and organizations to process information and make calculations is severely limited.

Figure 4 - 7
The Dual Economy in Urban Rental Housing

Characteristics	National-Professional	Local-Amateur
A. **Owners**		
1. Resources	High capital/labour ratio	Low capital investment; labour intensive
2. Motives, rationale of resource allocation	Net return to and/or increase of capital	Complex purposes, not all articulated
3. Recruitment	Via occupations, employment by owners, real estate sales, law, accounting. If via kin ties, the neophyte also has economic motives.	Self-recruitment, kin ties, being a tenant, having owned property in home country or rural area.
B. **Buildings**	Newer, larger, higher rental	Older, smaller, and low rental
C. **Tenants**	Middle and upper class	Middle, working and lower
D. **Relations of production and exchange**	Contracts are bargained defined in a wide context.	No contracts. Exchanges are negotiated in a local context, often via socially expanded relations.
E. **Managerial techniques**	Macro-cultural articulation of ("rational") strategies	Self-taught, local or ethnically based strategies
1. Evaluation of return to capital		None
2. Financing	All receive national and professional discussion via management literature.	Minimal
3. Tax planning, decisions		None
4. Maintenance	By paid staff or contracts	Self-taught, own input, hired labour minimized.
5. Relations with tenants	Through paid staff	Face-to-face contact
F. **Relation to organizations and institutions**	Uses commercial law to enforce contracts. Occupational organizations for owners, managers, developers or real estate business become lobby groups. Political consciousness, access, effectiveness at every level.	Self-enforcing agreements are sought via complex relations, personal sanctions. No owners' organizations, although some organization is possible via ethnic communities. No political consciousness, not even at city level.

Source: Krohn et al. (1977).

Individuals appear to search, evaluate and accept alternatives which are "satisfactory" to them, rather than attempt to maximize their utility. As long as an existing situation is satisfactory, individuals will not search for better alternatives. Thus, for example, in a complex rental housing market, individuals will rarely "vote with their feet" except when a significant change in their demands or a significant deterioration in services take place. If the search becomes more expensive, mobility declines and the threshold for acceptance (i.e., the definition of what is satisfactory) is adjusted. Only sharp changes in existing relationships between what is demanded, what is expected and what is supplied lead to a search for new options. These options include: moving, using the rent control machinery, engaging in individual bargaining, and organizing to share the costs of bargaining. The search for a new unit involves information collection (e.g., asking friends about rents they pay) and the determination of a price range considered reasonable for particular types of dwellings. This means there is a tendency to perceive the price in the market not in terms of "spot" market prices but in terms of the average price prevailing in the market.

Landlords can be divided into two types: (i) the professional, typically corporate, and (ii) the "amateur" landlord. Krohn et al. (1977, p. 1) have observed that:

> [i]t is generally accepted that rental housing is an economic enterprise in which landlords are motivated by expectations of good returns on capital investment. While this accurately describes its role in what we have called the national-professional economy, our study of urban rental housing ... has uncovered a local-amateur economy in which landlords are not motivated by high returns. And, unlike the businessmen and entrepreneurs who dominate the national-professional economy, these small owners are able to offer low rent housing in older, low-unit buildings. In the national-professional economy, the landlord's expectations of good returns coupled with high capital and labour costs have made it difficult to operate and impossible to improve low-rent housing without the support of government subsidies. This is not the case with the other economy, where small owners, through their

> own labour and various exchange relationships, have avoided paying nationally-set wage and interest rates. Through this study we have come to believe that low and moderate rental housing is always subsidized, either explicitly by government or implicitly and far more broadly by local-amateur economies.

Their model of the dual economy in urban housing is summarized in Figure 4-7.

Even the professional or corporate landlord, however, is not a simple maximizer of net worth or returns as the model implies. In the real world, corporations deal with complexity and uncertainty in a variety of ways. To reduce the costs of decision making and to ensure coordination, corporations develop standard operating procedures and standard programs which guide their decisions. These are often based upon heuristics, which are simplified decision rules that attempt to approximate the results of the more complex procedures of optimization without requiring much information or computation. For example, during protracted periods of inflation, investments are largely determined by cash-flow considerations. Typically many corporations determine the amount of their investments on the basis of the cash flow generated by their existing holdings. The criterion is to maximize the amount of investment which can be financed by the cash flow available, with some provisions for dividends and reserves.

This type of investment behaviour is characteristic of the professional real estate development corporations. It tends to closely approximate the maximization of net worth as long as inflation generates significant capital appreciation. Binding ceilings on rent levels would dampen immediately the level of new investment even if these ceilings provide normal rates of return on investment. It should be observed, however, that a positive level of investment can be expected even at low of rates of return as long as positive cash-flow permits investments to be made. (Framework 1 would predict that all new investment will cease under these circumstances.) (We have been told there are developers in Ottawa building rental housing because they are locked into a tax position where they have to continue to build to maintain the tax shelter for current income.) A protracted period of deflation, however, may lead to the reassessment of investment rules-of-thumb and the development of new heuristics reflecting the new economic realities. Standard operating procedures are slow to change and therefore one would expect long delays in the adjustment of economic behaviour. Generally, however, since decision making tends to be myopic, cash-flow considerations dominate economic concerns. For example, tax breaks which increase cash flow may have more impact than rational economic calculations would warrant.

While corporate landlords tend to have access to better information about market opportunities, small landlords are more likely to act in accordance with general expectations. A well-publicized announcement of allowed rates of increases in rents provides many small landlords and tenants with a signal of what is expected in the market. The extent of their price adjustments, however, will depend on their tenants' lengths of tenure in their dwellings and on the types of non-specific relationships that tenants and their landlords develop. Increases in cash costs (e.g., utility bills) will often determine the floor for rent increases, while the announced ceilings will tend to pull rents upwards.

Specific changes in rent regulations also affect the general "market climate" particularly where participants, in the short-run, are insensitive to fundamental economic relationships. For landlords, the climate is assessed in terms of the trend of restrictiveness or moderation that is implied by a particular change in regulations. For example, a recent empirical study (Gupta and Rea, 1984) indicates that (i) rent increases not subject to arbitrary decision by a rent control board, (ii) vacancy decontrol, (iii) no roll-back provision, and (iv) liberal conversion and tenure rules are, in that order, the most important features which are associated with "moderate" rent control regimes. Sunset provisions, the particular structures of the regulatory body, and other types of exemptions appear much less influential in forming landlords' attitudes. While the design of this study could be criticized, it does suggest that landlords can and do form an overall view of a control program. It is a view which may influence their decisions to stay or leave the market or trigger political action.

Finally, let us consider the rationing mechanisms for rental housing when excess demand exists in the controlled sector. We have discussed at length in Framework 2 the strong incentives which are created to ration illegally by demanding key money or adjusting illegally rents on vacancy. Another mechanism of rationing which we expect to be especially important in the amateur sector is rationing on the basis of income. Arnott (1984, p. 55) suggested that a law-abiding landlord "will choose easy tenants, those who will stay a long time, look after their apartments well, and not be a nuisance to their neighbours. If he feels that these characteristics are positively correlated with income, he will probably ration on that basis." Indeed, whether it is rationing through illegal charges or by income, high income households are clearly the winners.

6.2 The Politics of Rent Control

The analysis within Frameworks 1 and 2 focused upon considerations such as the allocative efficiency of a control system and the struggle of interest groups to secure benefits through state intervention. We have so far ignored ideologies and shared values which have an impact on the politics of rent controls. Willis (1950, p. 57) summarized the reasons used by the proponents of rent controls to suggest that the rental housing market has unique features which separate it from other consumption markets. The argument is that there is flexibility in most of the elements of the ordinary family's budget.

> If food costs go up, the family can usually exist on less food, and on cheaper food stuffs. If clothing costs rise, old clothes can be made to do. ...But rent is an inflexible charge. If it goes up, the tenant has little choice but to move to a less expensive lodging, and in times of housing shortgages the latter alternative is an illusory one. The result is a monopoly situation in which the state has to intervene -- just as it will intervene in other cases where monopolistic control of some element of the economy in which there is an intense public interest makes oppression probable.

More generally, see Stanbury (1985a, pp. 5-23 to 5-31).

This type of argument led some political parties to suggest that rental housing should be a public responsibility and the private role is both unnecessary and undesirable. The costs involved in providing public housing make rent control a more attractive proposition since it involves disguised taxation of those owning the capital stock at the time controls were imposed or made more stringent to subsidize the "exploitable" renters who lack market power. Such intervention by the state is justified on the basis of what Marcuse (1978) has called the "Malevolent Interest Theory". The theory "holds that the problems of housing are essentially caused by the rapaciousness of landlords, the greed of banks, the venality of real estate interests, the heedless drive for profits of contractors and developers" (Marcuse, 1978, p. 3).

The alternative ideological point of view considers protection of property rights an essential role of the state and views unrestricted market exchange processes as the ideal. Indeed, the position derived from this ideology would be for minimal state intervention in cases where the market fails (e.g., where monopolies or controls of landlords or strong tenant associations prevent competition). See, for example, Nozick (1974).

This ideological perspective certainly appears to legitimize the competition of groups for the generation and reallocation of economic benefits in the market. However, it also creates a highly selective information collection and interpretation process thus generating a momentum supporting entrenched positions with little attention to new evidence.

While the ideological debate and political-economic calculations focus upon the principle of intervention and the tightness of intervention, the design of the specific characteristics of implementation is responsive to shared notions of fairness in the community and general attitudes toward government intervention. Knetsch et al. (1984, p. 1) have observed that: "rental housing transactions are often considered to be different from those involving other goods and services and therefore to need special rules in order to ensure that all interests are protected in an equitable manner." These notions of fairness include: (i) arrangements that protect sitting tenants far more than new tenants, (ii) the endorsement of cost pass-throughs as the legitimate causes of rent increases, denying the role of price as mechanism for the adjustment to shifts in demand, and (iii) assigning responsibilities to the control program to protect tenants from unpredictable changes, while viewing individual tenants responsible for choices made without due care for protection from predictable events. Cost pass-through provisons, vacancy decontrol, exemption of new buildings, and tightening of controls in the face of unexpected rises in rents are, therefore, among the features more likely to win the approval of the electorate.

To conclude, the dynamics of the political system depend on several factors. First, it depends on the underlying economic and demographic conditions. For example, demands for rent controls or the tightening of rent controls will be lower in periods where the demand for rental housing is slack. Second, there is the balance of power between political parties and the degree of committment the various parties have to particular ideologies. For example, the degree of committment to an ideology may depend on the mood of the electorate, the timing in the electoral cycle -- the closer to a general election, the lower the committment to an ideology. Third, there are the costs of organizing a group to support a specific interest and the resources that can be mobilized. For example, in a large heterogeneous market, with many small complexes, it will be difficult to organize tenants. If ownership of the housing stock is concentrated it will be easier to organize landlords. Fourth, the dynamics of the political system will depend upon the prevailing expectations and shared values in the system with respect to controls. For example, if controls existed for a long time without obvious negative effects people will accept their legitimacy and tend to consider them fair. A marked deviation from the status-quo will tend to face resistance. The status quo is defined in terms of existing patterns of rates of change in the system. Unpredictable deviation from existing patterns of change will trigger demands for political action. See Stanbury (1985a, Ch. 2).

6.3 Effects: General Predictions

Framework 3 predicts that an important segment of the rental housing market would be less affected by rent controls. Indeed, it is the same sector (landlords with small holdings) which, as our analysis within Framework 2 predicted, will ignore or make agreements outside the control regime. Framework 3 provides the additional observation on the ability of small or "amateur" landlords to absorb operating cost increases excluding cash costs (e.g., taxes, utilities). It also suggests a general reluctance of these landlords to raise rents except as a means of preventing a negative cash-flow situation. On the other hand, the corporate landlord is predicted to be highly sensitive to myopic cash-flow consideration and less sensitive to long-term economic calculations under the assumptions of Framework 3.

Organization and mobilization of tenants in the corporate sector is likely to bring about a higher compliance with rent regulations. Landlords in both the corporate sector and the amateur sectors are likely to respond to changes in a regulation in terms of its perceived restrictiveness or moderation, than on the basis of calculation of precise economic effects. (The cash-flow implications of the specific change, however, will be an important modifier of behaviour in the corporate sector.)

The status quo with respect to any regulatory regime will have a special legitimacy. Thus, what is seen as restrictive or fair to each group would be measured against the existing system as the reference point. There is ample evidence to suggest that the adjustment people make in assessing uncertain prospects are affected significantly by the choice of a reference point (see Kahneman and Tversky (1979)). People also tend to have utility functions with an inflection point at the reference level (the status quo). Therefore, a unit of gain is less valuable than a unit of loss and, ceteris paribus, it is easier to mobilize participants to protect their stakes (to avoid losses) than to mobilize them to obtain greater stakes.

Let us analyze the specific effects which Framework 3 attributes to the various characteristics of rent controls.

6.4 Constraints on Rent Increases

The additional insights that can be gained from Framework 3 deal with two dimensions: (i) the perceived business climate in the rental sector, and (ii) impact on cash-flows. A permanent freeze or a roll-back of rents may, for example, have a more deleterious effect upon the sector than a reduction in cash-flows. Indeed, it may trigger a significant dissaving effort mainly through conversion and reduction in rental services. A system which provides for a change within the range of rates of changes characterizing other economic variables (say inflation rates) would not be considered restrictive. It will not bring about significant adjustment in outlays for new investments or major renovations or activities to upgrade the rental stock in the corporate sector. A fixed rate of increase, for example, will be judged when it is introduced as to its restrictiveness. But once it is in place it will be expected and therefore it will lose its significance in shaping perceptions of the business climate. For amateur landlords the restrictiveness of a maximum rate of rent increase will be judged in terms of its ability to cover increases in cash costs. Because of imperfect information and high transaction costs, non-automatic cost pass-through provisions will not resolve completely the cash-flow problems that small or amateur landlords will experience.

Generally, Framework 3 predicts that a system of rent increases that is adjusted to maintain a positive cash-flow without high transaction costs will minimize the impact of constraints on rent increases on the operation of both professional and amateur landlords. (In general, small/amateur landlords are strongly concerned with cash flow. We note also that typically smaller rental buildings in Ontario are much older than larger, high-rise buildings — see Chapter 7, Appendix B.) Framework 3 predicts that under certain circumnstances the publication of maximum increases in rent levels will pull rents upwards, not just because landlords want to ensure a future higher rent base, but because such an announcement will influence the expectations of both landlords and tenants. Clearly such increases will be internalized into the standard operating procedures of corporate landlords. (We shall discuss later the circumstance where such corporations are motivated to develop expertise to utilize pass-through provisions in the regulation.)

6.5 Coverage

Framework 3 provides a contradictory prediction to the one derived for the controlled and uncontrolled markets in Frameworks 1 and 2. Framework 3, which emphasizes the behavioural aspects of rental housing markets, postulates that tenants perceive average rents in the market as "anchors" in determining whether or not an available dwelling is "reasonably priced". The larger the controlled portion of the market, the fiercer the resistence tenants may have to higher prices in the uncontrolled sector. Tenants who must choose accommodation in the uncontrolled sector may view it as temporary and will continue to search for a unit in the controlled market.

The high turnover predicted in the uncontrolled sector will increase the costs and therefore reduce the rate of return of landlords. This will tend to reduce the quantity of housing services offered by such landlords. Some landlords in the uncontrolled sector may attempt to shelter themselves from the negative spill-over by product differentiation. This may take the form of exclusive constraints on the type of tenant which may have access to the units and will thus reduce further mobility in the market.

The effects of decontrol mechanisms will depend on the degree of legitimacy they are perceived to provide for illegal market transactions. For example, vacancy decontrol may be perceived to vest the authority for decontrol in the tenant. This is so because he can bring about decontrol simply by moving. Thus he and the landlord may consider contracting out of controls by mutual agreement to be a legitimate move although formally prohibited by the law. In addition, decontrol provisions may be interpreted as signals of intentions by the government or the regulator about phasing out controls, thus encouraging informal decontrol activities.

6.6 Cost Pass-Through Provisions

The predictions of Framework 3 in respect to cost pass-through provisions are similar to those of Framework 2. High transaction costs and ignorance present effective barriers to the extensive use of cost pass-through provisions by amateur landlords.

In the corporate sector new standard operating procedures (SOPs), and the expertise associated with their development and application, will be implemented only in response to the threat of negative cash flows. However, once such SOPs are developed they will be employed automatically. Thus, Framework 3 will predict a high level of repeat applications for rent review by professional landlords. Each cash-flow "crisis" triggered by inflationary pressures will increase the base of landlords (and their advisors) with expertise in obtaining concessions from the regulatory authorities, thus creating an upward trend in the number of applications for review. This means higher administrative costs for the government as well higher transaction costs for landlords. Indeed, if budgets for rent control administration are constrained, prohibitive transaction costs could in extreme cases lead to a breakdown of the system. It could also lead to pressures to simplify the system and eliminate those provisions designed to "fine tune" it so as to ensure equity.

6.7 Applications of Framework 3

Framework 3 recognizes that many participants in the market are neither profit nor utility maximizers nor endowed with refined abilities to make choices that reflect information at hand. It recognizes that the status quo affects both perceptions and values of participants in the rental housing market. The framework is useful to further modify predictions made within Framework 2, especially with regard to the "amateur" landlord sector of the market in low-income areas and with regard to the mobility of tenants within the controlled market and between the controlled and uncontrolled markets.

6.8 Framework 3: Major Implications

6.8.1 Regulators and Political Activity

- Ideologies provide ready-made definitions of agendas for rent control especially in intra-party debates.

- The ideological perspective of a political party or an interest group creates a highly selective information collection and processing. This means that entrenched positions can be maintained with little attention to new evidence.

- The degree of commitment to an ideology may depend on the mood of the electorate and the timing in the electoral cycle -- the closer to a general election, the lower the pure commitment to an ideology.

- The priorities of the political agenda are sensitive to individual dramatic cases of hardship even if they are statistically insiginificant. Often public attention to specific publicized cases is far more intense than attention to arguments based on comprehensive demographic and economic data. This is because the public can more easily understand a specific case rather than the general situation.

- The dynamics of the political system will depend upon the prevailing expectations and shared values with respect to controls. For example, if controls existed for a long time without obvious negative effects people will accept their legitimacy and tend to consider them "fair". A marked deviation from the status-quo will tend to face resistance.
- Unpredictable deviations from existing rates and patterns of change (not absolute levels) will trigger demands for political action.

6.8.2 Effects

We must reiterate that in contrast to Frameworks 1 and 2, many of the hypothesized relationships derived in Framework 3 are not based on deductive reasoning. Indeed, behavioural theories are derived inductively from specific observations. They often provide good predictions, but one must be careful in judging whether they are relevant in particular circumstances. Such judgment is often based on intutitive reasoning.

- Tenants perceive market price not in terms of "spot" prices, but in terms of the average quality-adjusted rents in the market. This creates (i) resistence to the higher rents charged in the uncontrolled sector, and (ii) higher turnover and therefore higher average costs in that sector. The result is a shift to the left of the supply curve and a lower quantity of rental housing services supplied in the exempted sector.
- Corporate landlords respond to lower cash-flows resulting from binding ceilings on rent increases by reducing investment. This reduction may take place even if the marginal rates of return on capital are adequate. The reduction will reflect the lower cash outlay budgeted for investment as well as the lower debt to equity multiples that financial institutions allow in granting credit.
- A well publicized announcement concerning the permitted rate of increase in rents is interpreted by many small landlords and tenants as a signal of what

is expected in the market. The standard operating procedure is to implement the maximum published increase when rents may be changed.

- Trends of perceived overall restrictiveness of rent controls influence investment and disinvestment decisions. Thus a move which does not have any direct impact upon the flow of funds but is considered restrictive may curtail investment or lead to disinvestment in the rental housing market.
- Amateur landlords, to a large extent, are able to absorb increases in operating costs excluding cash costs (e.g., taxes and utilities). Thus a general system of rent increases which is sensitive to changes in cash costs will be seen to meet the needs of this sector. See Ekos Research (1985).
- Amateur landlords are generally reluctant to raise rents except as a means of preventing a significant deterioration in their cash-flow situation. See Ekos Research (1985).
- Corporate landlords are sensitive to myopic, cash-flow considerations and less sensitive to long term economic calculations. Thus government "public housing" programs (e.g., MURB) generate an expansion in new building which may not be warranted by pure economic calculations.
- A permanent freeze or a roll-back in rents will have a far more deleterious effect on landlords' behaviour than the adjustment that is warranted by economic and cash-flow considerations alone. A system of rent increases which provides for a rate of change within the range characterizing the major economic variables (e.g., inflation rates) would not be considered restrictive. It therefore will not bring about significant adjustment in the outlays for new investment or major expenditures on upgrading the stock.
- Because of imperfect information and high transaction costs, non-automatic cost pass-through provisions will not resolve completely the cash-flow problems that amateur landlords experience.
- Informal, partial vacancy decontrol is likely to be prevalent in the amateur sector.

- Landlords with large holdings are more likely to use the regulatory machinery to obtain higher rent increases. As a company gains "expertise" in using the machinery it is likely to use it more often. Thus, each cash-flow "crisis" triggered by inflationary pressures will increase the cumulative number of landlords with expertise, creating an upward trend in the number of applications for review by the regulators.
- In the absence of black markets, rationing in the amateur landlord sector, when excess demand exists, will be based in part upon tenant income. This is a heuristic approach to nuisance minimization.

7.0 CONCLUSIONS AND POLICY IMPLICATIONS

We have described in this chapter three theoretical frameworks for the analysis of systems of rent regulation. Each framework provides the policy analyst with a perspective which focuses attention upon a particular set of characteristics -- see Figure 4-1. These characteristics may accurately portray behaviour of a segment of market participants (e.g., corporate landlords versus amateur landlords) or the behaviour of all participants when certain external conditions affect the market. Thus the three frameworks are not designed to be mutually exclusive, but are meant to be used as alternative but complementary perspectives in analyzing the impact of rent regulation.

By searching for a fit between the characteristics of each framework and actual behaviour in the market, one can identify groups of market participants whose behaviour is best predicted by a particular framework. Thus it is likely, for example, that landlords with small holdings, in the short run, are likely to behave as postulated in Framework 3. Corporate landlords, in the short run, are likely to behave as postulated in Framework 2. However, if the environment is stable, their behaviour in the long run will fit well with the patterns predicted in Framework 1. In contrast, large corporations that are likely to employ professional economists in the planning process, may, in a stable environment, approximate the behaviour of "rational decision makers" postulated in Framework 1 in the short-run. Clearly, the technical-economic sophistication of landlords and tenants, the homogeneity of the market, the clarity and predictability of the system of rent control as well as the degree of uncertainty in the market environment, will be the main factors that must be considered in weighting the predictions derived from analysis within the alternative frameworks to reach a synthetic view of the rental market.

In Ontario, for example, we identify a significant proportion of the landlord and tenant populations which fits the characteristics of both the amateur sector in Framework 3 and the idiosyncratic economic system of Framework 2 -- see Chapter 7. We also identify those groups of corporate landlords which in their investment decisions approximate the rational behaviour of Framework 1 and those with "myopic, cash-flow sensitive" behaviour described in Framework 3. We also identify the segments of the market (mobile tenants in small buildings) that are vulnerable to illegal market adjustments. Thus our policy assessment is able to reflect the predictions derived from alternative frameworks for specific market segments and the weight each segment carries in the rental housing market.

Notes to Chapter 4

1. Ekos Research (1985) surveyed 210 landlords owning small to medium sized buildings in southern Ontario in Mid-1985. They state that

> direct negotiations are extensive - just under half of landlords who have never participated in rent review claim that tenant agreement to the increase was an important factor in their decision not to participate and these landlords represent almost one quarter of the total population of landlords. Twenty per cent of participants (10 per cent of the total sample) attempted to negotiate the rent increase before finally applying for a rent review hearing. In other words, 35 per cent of our sampled landlords have tried to negotiate rents. (Ekos Research, 1985, p. 112)

They also state that

> Individual sole owners and husband and wife co-owners are most likely to have tried to negotiate rents (30 and 27 per cent respectively) and corporations, limited companies and unrelated partnerships least likely (four per cent, $p < .10$. This is probably, at least partly, a function of the number of tenants involved - direct negotiations are probably easier when there are relatively few tenants. (Ekos Research, 1985, p. 44).

Ekos Research (1985, p. 50) indicate that

> 30 per cent feel RTC approval is not required for higher than allowable increases if the tenant agrees to the increase and a further five per cent did not know whether or not approval is required. Twenty-two per cent of landlords feel they can raise rents with impunity if the tenant's lease is up and another seven per cent do not know the answer. Nineteen per cent feel it can be done to correct a negative cash flow, and an additional nine per cent do not know the answer.

2. Ekos Research (1985, p. 39) states:

> The 52 per cent of landlords who had never applied for a rent review hearing were asked how important they felt a variety of possible reasons for not applying were to their decision not to apply. The most important reasons concern the landlord's perceived ability to participate: ... 62 per cent were unwilling to cope with the paper work (44 per cent cited this as an extremely important factor in their decision) and 61 per cent felt the cost of hiring assistance for the hearing would be too high (46 per cent indicated this reason was extremely important). More than half of non-participants [54%] feel intimidated by what they anticipate the process will require.

3. Ekos Research (1985, p. 107), based on a study of 210 Ontario landlords, estimates one-fifth to one-third of landlords are circumventing the legislation. Mascall (1985, pp. 79-80) states

> Of the 279 properties visited in Toronto 42, or 15 percent, were on record at the Residential Tenancy Commission (RTC) .... Seven records of the 42 percent were not available as their cases had not been decided upon or they were out of their files. Of the

remaining 35 cases, 19, or 54 percent of the landlords were charging in excess of the annual 6 percent increases. The average excess rent of those 19 units charging above the RTC maximum was $151, a surcharge of 34 percent. Based upon the 35 units on RTC records, the average excess charge per unit was $82 per month.

4. Ekos Research (1985, p. 110) reports that participation in rent review "also seems to have a negative impact on both tenant relations and landlord attitudes alike. Just under half of landlords reported a deterioration in their relations with their tenants as a result of the last hearing."

Chapter 5

DESIGN CHARACTERISTICS OF RENT REGULATION IN ONTARIO

1.0 INTRODUCTION

In this chapter we describe the specific details of the Ontario system of rent regulation as it stood on January 1, 1985. (A number of important changes were made later in 1985. See Stanbury & Thain, 1986, Ch. 9.) Our objective is not to replough the ground so thoroughly covered in Phase I of the Commission of Inquiry into Residential Tenancies and dealt with in Commissioner Thom's (1984) report. Rather we wish to complement that large body of work by recasting the elements of the present system of rent regulation within the framework we prepared to analyze rent control schemes in general in Chapter 2. By grouping the "nuts and bolts" of Ontario's system into functional categories we can better assess the nature of the system in relation to rent control schemes in other jurisdictions.

Furthermore, we need to appreciate that the design characteristics, and particularly the detailed implementation of specific characteristics, of a rent control scheme is seldom static. Since controls are often legislated in haste in response to a perceived crisis, it is not surprising that considerable "learning by doing" occurs and that it is necessary to amend the original (and subsequent) legislation in the light of experience. Therefore, after describing Ontario's system as of the beginning of 1985 we then describe the evolution of controls in Ontario during the decade that they have been in effect (see also Stanbury, 1985c). The second major objective of the chapter is to examine the activities of the two regulatory bodies responsible for the administration of rent regulation in Ontario: the Residential Premises Rent Review Board (1976 to 1979), and then the Residential Tenancy Commission -- see section 5.0.

2.0 ONTARIO'S SYSTEM IN GENERAL

Where does one look to determine the substantive and procedural elements of Ontario's system of rent regulation? We have identified six principal sources of information on the details of how rent review operates:

(i) The Residential Tenancies Act, Part XI of which contains many of the statutory provisions regarding rent review.

(ii) The Landlord and Tenant Act which contains important provisions regarding security of tenure that constrain a landlord's ability to remove a rental unit from the controlled stock.

(iii) The Regulations under the Residential Tenancies Act and the Landlord and Tenant Act - these items of subordinate legislation have the same legal force as the statutes themselves, but may be enacted, amended or rescinded simply by order of the Lieutenant Governor in Council, i.e., the Cabinet.

(iv) The Interpretation Guidelines issued by the Residential Tenancy Commission. As of March 1984 there were 17 Procedural Guidelines and 18 Rent Review Guidelines covering more than 200 pages. In practical terms, these Guidelines provide the details as to how the RTC functions in dealing with landlord and tenant requests. However, as the courts have determined, the Guidelines do not have the force of law, i.e., they are not regulations. In practice, changes in the Guidelines are applied retroactively to applications filed pursuant to previous established Guidelines. In contrast, unless stated explicitly in the statute, no Act of the Legislature has force retroactively. Guidelines can apparently be applied retroactively because they do not have the force of law. Yet from the point of view of landlords and tenants, how the Commission defines and applies the Guidelines is "the law" in the sense of what they can and cannot do under rent review. See Stratford (1982, 1985).

(v) The decisions of the Residential Tenancy Commission including those of the Appeal Panels - the most significant ones, as perceived by the RTC itself, are published annually. As in many areas of administrative law, the law is what the regulators say it is or - much less frequently - what the Courts say it is upon appeal. Grounds for appeal to the Courts are limited to alleged errors in the interpretation of the law. In practice very few appeals are taken to the courts and very few of these are successful because of the wide discretion granted to the regulatory body (RTC) is the legislation and because the Guidelines do not have the force of law.

(vi) The Residential Tenancy Commission's Procedures Manual - while designed primarily for the use of the RTC staff, is available to the public at all of the Commission's 21 field offices. It describes how applications are to be filed and the procedures regarding hearings and appeals. In addition, the RTC publishes a "Guide to the Cost Revenue Statement in Support of Rent Review Applications" to assist landlords in preparing data necessary for a whole building review.

The legal framework for Ontario's system of rent regulation merits some general comments. First, as we have just described, there are several sources of statutory authority (including subordinate legislation) that must be canvassed in order to begin to understand the system. In addition, there are as many categories of related materials that must be understood before one can fully appreciate exactly how the system operates in practice. This means that the average tenant and the small landlord (who provide about one-third of all rental units) are likely to have some difficulty in understanding the full ramifications of the system. As we have noted in Chapter 4, there are economies of scale in dealing with rent controls. As a result, the landlords of large buildings and large organizations of tenants will find it easier and less costly on a per-unit basis to acquire the specialized knowledge to obtain the maximum benefits available under the rent control system.

Second, the regulator - as is frequently the case in government regulation - has been given a very wide range of discretion in determining the details of the regulatory regime in Ontario. The statutory basis of rent control in Ontario provides only the outline for the system. Regulators have been given the task of "filling in" the enormous number of "blanks" left by the Legislature. Why is this the case? Two theories may be advanced to explain the behaviour of the politicians who formed the majority in the legislature and have created the system of rent regulation. The first is that legislators who delegate enormous amounts of discretion to regulatory bodies to "make up to law as they go along" are behaving irresponsibly. They may be engaging in an act of symbolic politics in setting up a regulatory body and care little about what particularly substantive or procedural results it produces. The greatest mileage for the government of the day (and even the opposition parties that support the new form of government intervention) lies in the initial action to "legislate against sin" (rent gouging) and to be seen to create a body officially responsible for seeing that sin (rent increases) is properly regulated. As one observer remarked in regard to most regulatory tribunals in the U.S., what happens often amounts to Congress saying to the regulatory body it created - "here is a problem and here is some statutory authority - you deal with it."

The second theory is based on the enduring and often charmingly naive faith in experts. Here it is assumed that the Legislature fully appreciates that it cannot determine in great detail, a priori, all the rules necessary to regulate rents in a complex housing market. Moreover, it appreciates that changing circumstances (needs, pressures, economics, political concerns) will require changes in the operative regulations governing the subject matter being regulated. Therefore, the Legislature - so this theory maintains - wisely establishes only the general framework for the new regulatory regime and leaves it to its independent experts to "put some meat on the statutory bones." In any event, it is argued, the government of the day is free to "monitor" the activities of the regulatory body and on the basis of this information and in response to loud political noises it can bring forth new legislation designed to alter or to reinforce the decisions of the regulators. Part of the faith in experts is the idea that what experts are being left to deal with are the less important "technical" matters rather than important political questions. Trebilcock (1978, p. 94) refers to this idea as one of the "central myths about public regulation of economic activity." It is a myth, he says, that "most regulation involves technical questions which are of little interest and relevance to the average person which can safely be left to 'experts' for disposition. Nothing could generally be further from the truth. Most major regulatory decisions ultimately involve matters of immense political and social importance."

Our third observation - upon which we will expand below - is that regulation is a dynamic process. Even where the statutory framework remains unchanged, "expert" quasi-judicial regulatory tribunals alter their interpretations of the statutes and they effectively create new "law" by making decisions on issues that were not addressed in the framework legislation. As important are the changes in statutes and regulations created in response to political pressures. See Stanbury (1985c) and Stanbury and Thain (1986, Ch. 9.)

Fourth, the "nuts and bolts" of Ontario's system of rent regulation are not contained in the two key statutes and their regulations. They are contained in the Interpretation Guidelines issued from time to time by the Residential

Tenancy Commission, see Stratford (1982, 1985). Yet, as we have noted, these extensive and very detailed Guidelines are not law, nor do they formally have the force of law. Therefore, they can be changed retroactively, and without the need to follow the procedural steps which have to be observed in regulations. Yet, from the viewpoint of both landlords and tenants the Guidelines are "the Bible" when it comes to how they are to proceed before the RTC. In order not to fetter the extreme discretion conferred on the RTC, the Guidelines are not binding on any individual Commissioner or Appeal panel. Yet in practice, both make decisions as if the Guidelines represented official policy. However neither landlord or tenants can appeal to an Appeal Panel of the RTC or to the courts on the basis that in a specific case a Commissioner deviated widely from long-published Guidelines. The paradoxical nature of the role of the Interpretation Guidelines is further illustrated by the fact that it took some time to have the Guidelines made public. Their availability was not originally provided for by statute although the 1979 Act required that they be made public [S.82]. Prior to that time the Guidelines were cited and largely followed in decision making by the RTC, but they were not generally available to the parties.

With these general comments by way of background, we turn to a more detailed review of the design characteristics of Ontario's system of rent regulation as it stood in January 1985 and how it evolved since it was first enacted on December 18, 1975.

3.0 DESIGN CHARACTERISTICS

Following the structure developed in Chapter 2 we divide the design characteristics into two main sets of rules: those that define the substantive provisions of the system of rent controls, and second, the administrative characteristics of the system.

3.1 Substantive Rules

The substantive rules of Ontario's system of rent regulation can be grouped into five categories:

- The Universe of Controls
- Determining the Base Rent
- Method of Determining Allowed Increases in Rent
- Rules Restricting the Removal of Units from the Controlled Stock
- Other Rules

(1) The Universe of Controls

(a) Stock Rules

The following rental units are exempt from Part XI of the Residential Tenancies Act (rent review) in Ontario:

- units situated in a complex owned, operated or administered by the federal, provincial or municipal governments (this category including co-operatives and non-profit housing contains about 13.6% of all rental units as of 1981 -- see Pringle (1985, Figure 4.1);
- units in non-profit (including non-profit co-operatives) housing that are subject to the approval of one or more level of government;
- units provided by educational institutions where there is an association representing the residents which is consulted about rent increases;
- units in complexes owned or administered by religious institutions for a charitable use on a non-profit basis [S. 134]; and

- In addition, S.4 of the Residential Tenancies Act states that it does not apply to:

- transient living accommodation in a hotel, motel, etc.;
- vacation homes;
- living accommodation conditional upon farm employment;
- non-profit co-operative housing;

- living accommodation occupied by a person for penal correctional, rehabilitative or therapeutic purposes or for the purpose of receiving care;
- temporary shelter for persons in need;
- living accommodation in hospitals, nursing homes, and homes for the aged;
- living accommodation provided by an educational institution to its students or staff;
- living accommodation in primarily non-residential buildings provided associated with employment; and
- premises occupied for business or agricultural purposes with living accommodation.

• It is estimated as of mid-1981 that 77.2% of the rental units in Ontario were subject to rent review. See Pringle (1985, Figure 4.1).

Earlier Legislation Regarding the Universe of Controls

• The 1975 Act did not apply to residential premises or rental units that were located in a building of which no part was occupied as rented residential premises or a a rental unit before January 1, 1976. This provision did not change between 1975 and 1985.

• Tenants living in limited dividend housing, in units owned by the Ontario Housing Corporation, and people who were living in rooms (boarders) were not covered under the 1975 Act. Residential premises subject to control included any dwelling unit that contains a bathroom and kitchen facilities facilities or land used as a site for a mobile home.

• Under the 1976 amendments effective January 16, 1976 certain types of rental premises of a non-profit or government-owned nature were exempt from the legislation.

- Under the 1975 Act and the 1979 Act, boarding and rooming houses were specifically included in the definition of "rental unit". The Act also exempted other living accommodations not specifically referred to in the 1975 Act.

(b) Geographic Scope

- The controls extend throughout the province of Ontario. There are no local or regional exemptions, although for administrative purposes the province is divided into nine regions. See Regulation 902 under the Residential Tenancies Act.

(c) Flow Rules

(i) New Construction

- Rent controls under S.134 of the Residential Tenancies Act do not apply to rental units located in a building of which no part was occupied as rented residential premises or rental unit before January 1, 1976. This provision exempts new rental buildings which "opened for business" after January 1, 1976 (Thom, 1984, p. 9). (This was changed in late 1985 - see Stanbury and Thain, 1986, Ch. 9.)

- Units in mobile homes or mobile homes sites not occupied as rentals before January 1, 1976 are also exempt.

- These provisions have not been changed since the original 1975 Act.

(ii) Conditions for De-controlling Units

- There is no provision for vacancy decontrol. Controls apply to the unit, not just the sitting tenant.

- Ontario Regulation, O. Reg. 168/80 promulgated in 1980 pursuant to the 1979 Residential Tenancies Act provided that units with a monthly rent of $750 or more were exempt from rent review. Therefore, as the rent on a unit rose past $750 per month, the unit left the controlled stock (see Thom, 1984, Ch. 14). However, the law was changed in November 1984 to effectively remove the $750/month exemption.

- When controls were originally enacted on December 18, 1975, they were made retroactive to July 29, 1975. They were to expire August 1, 1977. Controls were subsequently extended for short periods several times. Then in November 1979, the "sunset" clause was removed, i.e., controls became "permanent" or at least "without term."

- S. 128 of the 1979 Residential Tenancies Act provides that "where a rental unit that has not been rented during the previous twelve-month period then becomes rented, the rent then charged shall form the basis for determining whether subsequent rent increases exceed [6%] ..., provided that the rent charged is comparable to the average rent charged for similar rental units in the residential complex". While this provision would appear to fall under the next category, conditions for controlling previously exempt units by means of Rent Review Guideline No. 9 the RTC has effectively defined a way of "escaping" from controls if the landlord has undertaken a very extensive renovation of a unit. RR-9 states that "if the renovations are so substantial as to effectively create a new rental unit, the unit would become a rental unit that has not been rented during the previous twelve-month period, within the meaning of section 128. The landlord would be able, therefore, to set a new rent for the unit without regard to the 6 percent limit." More generally, see Thom (1984, pp. 42-44) who notes that "The Guideline is an attempt to deal with a situation that is not covered by the statute". However "in doing so, it gives a meaning to section 128 that is not apparent on its face".

Earlier Legislation Regarding Conditions for De-Controlling Units

- The most significant new potential exemption in the 1979 Act was for units with a monthly rent of $750 or more. The Cabinet did not promulgate the specific regulation required for this "luxury exemption" until 1980. It was rescinded in November 1984.

- Regulation 900 under the Residential Tenancies Act was revoked. That is, rental units, the monthly rental for which is $750 were no longer to be exempt from Part XI of the Act (Ont. Reg. 168/80, s.1).

(iii) Conditions for Controlling Previously Exempt Units

- There are no provisions in the Ontario system to deal with this issue.

(2) Determining the Base Rent

- Rent controls in Ontario were enacted on December 18, 1975, but they were made retroactive to July 29, 1975, the day before the Premier had announced that rent review boards would be established in Metro Toronto and other cities with a serious shortage of rental housing (see Stanbury and Thain, 1984, p. 6-16).

- The statutory rates of increases (8% per annum from August 1975 and 6% p.a. from October 27, 1977) or increases allowed under rent review by order of the regulatory body were to be applied to the rent in effect in July 1975 (Thom, 1984, p. 217). However, the legislation contains no formal definition of the base rent. Commissioner Thom (1984, p. 45) notes that under rent review the total increase in rent for a residential complex is to be determined and apportioned among the various units, but that "nothing is said in the legislation ... about the base to which the apportioned amount of a permitted rent increase or a statutory increase is added in order to arrive at the maximum rent that may be charged for a unit". Nor does the RTC's Rent Review Guideline No. 17 indicate how the base rent, described as the "present monthly unit basic rent", is determined. Some indication, however, can be gleaned from Rent Review Guideline No. 13 which deals with illegal rents in the context of a landlord's application for rent review. A Commissioner has the power to determine the proper or "current lawful rent" (see Thom, 1984, pp. 46-47). Presumably, the original base rent is the rent that a unit commanded in July 1975 -- six months before controls were enacted.

(3) Method of Determining Allowed Increases in Rent

(a) Amount of Increase per Period

- No landlord can increase the rent charged on a rental unit by more than 6% of the last rent for an equivalent rental period without the authorization of the Commission. [S.125] (Effective August 1, 1985 the statutory rate was reduced to 4%. Between July 1975 and October 27, 1977 the statutory rate of increase was 8%.)

- Landlords wishing to increase rents by more than 6% (the statutory rate) must apply to the RTC for a Whole Building Review, i.e., for all the rental units in a residential complex. [S.126] The application must state the reasons for the proposed increase (e.g., increased operating expenses, increased financing payments, financial hardship, capital expenditures, or financial loss) and must be filed at least 60 days before the effective date of the first intended rent increase.

- The RTC is required to determine the total rent increase for a residential complex that is justified by
  - the findings of the Commission concerning operating costs, financing costs and capital expenditures that the landlord has experienced or will experience in respect of the residential complex;
  - the findings of the Commission concerning a financial loss that the landlord has experienced or will experience in respect of the residential complex;
  - the findings of the Commission concerning an improvement or deterioration in the standard of maintenance and repair of the residential complex or any rental unit located therein;
  - the findings of the Commission concerning matters prescribed by the regulations. [S.131]

- Under the Act to provide for an Interim Restraint on the Pass Through of Financing Costs in respect of Residential Complexes (enacted in December 1982), the total increase in rent attributable to such increases in financing costs may not be more than 5% of the total of the last lawful rents for the complex with respect to residential complexes that have been purchased more than once after October 31, 1979. (This provision, which was to expire December 31, 1985 was later extended - see Stanbury and Thain, 1985, Ch. 9.)

- Tenants may apply to the RTC for an order requiring the landlord to return any rent in excess of the lawful rent and to declare the legal rent.[S.129]

- In the case of an application by a tenant, the Commission shall consider only the following factors in determining a rent increase:
  - Variations, and the reasons therefore, in the rents being charged by the landlord for similar rental units within the residential complex.
  - Rents being charged by other landlords for similar rental units situated in similar residential complexes within the same geographical vicinity.
  - An improvement or deterioration shown to have occurred in the standard of maintenance and repair that affects the rental unit. [S.132]

- Following its hearings on applications by a landlord or a tenant regarding a rent increase, the RTC is required to make an order "setting the maximum rent that may be charged for each rental unit that is under review and the date the rents may take effect" [S.131]. In addition the Commission may order the landlord or tenant to pay to the other any sum of money that is owed by reason of its decision in setting the maximum rent.

Earlier Legislation Regarding the Determination of Increases in Rent

- Under the 1975 Act, until the Rent Review Officer made his decision, a rent increase up to the 8% limit established by the Act could be collected by landlords.

- Under the 1975 Act rent increases could be determined on a building basis rather than a unit basis at the discretion of the Rent Review Officer.

- Under the 1975 Act, a tenant could dispute any rent increase ordered by a Rent Review Officer. There was no restriction on the matters that could be raised for consideration at the hearing.

- Section 9 of the 1975 Act provided that a discontinuance of services or privileges to a tenant was deemed to be an increase in rent. Section 11 of the 1975 Act permitted an application to the Rent Review Officer for an order of reduction of rent where there had been such a discontinuance.

- Section 7(3)(a) of the 1975 Act provided that a Rent Review Officer could approve an increase sought by a landlord if he was satisfied that increased operating costs and capital expenditures justified the increase. Section 7(2)(b) directed the Rent Review Officer to consider whether increased rents sought by the landlord were necessary in order to prevent the landlord from suffering a financial loss in the operation of the building.

- Under amendments effective April 29, 1977, instead of a formal notice of justification, the landlord would be permitted to supply written reasons for the proposed increase. A new provision prevented a tenant from raising the issue of insufficiency of notice after the Rent Review Officer made his order if the tenant did not raise the issue at the hearing.

- The primary change that affected the Board's operations under the 1977 amendments was the introduction of Section 13(7) which permitted the Board to reconsider a decision within 30 days after issuance of its order following an appeal hearing. Previously, there was no recourse for correction if it was determined that an error had occurred. The provision as amended still required the Rent Review Officer to give a copy of his order to all parties who appeared at the hearing, but did not require him to supply copies of the reasons except to those parties who requested a copy of the written reasons.

- The 1977 amendments clarified the issue that where there was a discontinuance of services, it shall not be considered to violate the minimum

12 month period between rent increases. It would still be open to the tenant to apply for a rent reduction under Section 11 of the Act.

- The statutory rate of rent increase (i.e., increases without review) was decreased from 8% to 6%, effective October 27, 1977.
- The 1979 Act departed radically from the 1975 Act by taking away from tenants the right they had under the 1975 Act to require the landlord to justify an intended statutory increase. A tenant still had the right to dispute an intended statutory increase but the matters that can be considered by the Commission in disposing of the application were limited and did not include a review of a landlord's costs. Hence, although the right to dispute a statutory rent increase was in the 1979 Act, it was not of great significance.
- However, the tenant does have a right under the 1979 Act, which he did not have under the 1975 Act, to apply for an order directing repayment of excess rent, referred to in a marginal note as "illegal rent", and for an order declaring the rent that may lawfully be charged for the unit occupied by him.
- An important change made by the 1979 Act was the requirement for a whole building review under S.126 following a landlord's application for a rent increase in excess of the statutory rate. This meant that landlords could not use the 6% limit for some units, while applying for rent increases on other bases for other units.

For more detail, see also "Earlier Legislation Regarding the Treatment of Owner's Investment" below.

(b) The Apportionment of Increases

- The 1982 Interim Act changed the method of apportioning among the tenants the total rent increase allowed on a whole building review. The operation of subsection 131(4) of 1979 Act was suspended. Instead, the Commission was required to apportion the total rent increase determined under subsections

131(1) and (3) of the 1979 Act equally amongst rental units in the residential complex on a percentage basis. The landlord may increase the rent charged for each rental unit in the residential complex by an amount not exceeding the amount set out in the Commissioner's order.

Earlier Legislation Regarding Apportionment

- The 1975 Act did not provide for whole building review, hence, apportionment of the total rent among all rental units in the complex was not provided for.

- Under the 1975 and 1979 legislation, in a whole building review, apportionment of rent increases was usually based on a rent schedule prepared by the landlord. A common practice was to apportion the increases among the units so that rents charged to similar units became more or less similar. That practice was referred to as equalization.

(c) Treatment of the Owner's Investment

- There is no explicit provision that refers to the allowed return on capital an owner may receive. However, provisions in the Residential Tenancies Act implicitly refer to the owner's investment or direclty affect it. Therefore, one must also refer to the general provisions regarding the determination of rent increases above.

- Financing costs resulting from the landlord's purchase of a residential complex are to be considered only to the extent necessary to prevent a financial loss by the landlord. For more details on how these losses are recovered over time, see Rent Review Guideline No. 4.

- The 1982 Interim Act dealt with the pass-through of financial loss as follows: that portion of a rent increase attributable to increased financing costs claimed by a landlord as a result of his purchase of a residential complex is limited to 5%.

- Relief of hardship: when the total rent increase under a Whole Building Review does not exceed the operating and financing costs and capital expenditures by at least 2%, the RTC may, where it considers it necessary to relieve the landlord from hardship, allow the landlord the additional revenue to not more than 2% above the costs found.[S.131(3)] However, this section is suspended whenever a part of the rent increase to be determined is attributable to increases in financing costs resulting from any purchase of a residential complex.

Earlier Legislation Regarding the Treatment of the Owner's Investment

- A provision dealing with relief of financial hardship for landlords was not included in the 1975 Act, although it was subsequently included in the 1979 Act.

- The Rent Review Guidelines established following the 1979 Act suggested that substantial costs (such as capital expenditures and increased financing payments resulting from a rent purchase) and losses be passed through over more than one year to avoid extremely high percentage increases.

- The 1979 Act specifically recognized financing costs as an item to be taken into consideration in determining justified rent increases.

- An allowance to relieve a landlord's financial hardship could be made. Subsection 131(3) was a new feature of rent review.

- In the 1979 Act, the provisions regarding financial loss in Section 131 were of the most general nature. However, the Rent Review Guideline No. 4 allowed a rental increase which would be sufficient to bring a landlord to a 'break-even' position over a period of time up to five years. This guideline was revised in November 1982 just before the 1982 Interim Act was passed.

- Section 4 of 1982 Interim Act stated that the operation of subsection 131(3) of 1979 Act is suspended whenever a part of the rent increase that is to be determined is attributable to an increase in financing costs resulting from any purchase of a residential complex. Under Section 4, consideration cannot be given to granting a hardship allowance until after the pass-through has been completed.

(d) Treatment of Capital and Maintenance Expenditures: The Cost Pass-Through System

- All projected increases in operating costs are allowed, including salaries and payment in kind to caretakers, insurance, municipal taxes, utilities, maintenance, bad debts less recovery and management and administrative overhead (including vacancies) at a maximum of 5% of revenue for units in buildings and 10% for units in mobile homes and consultant's fees. Operating costs also include interest and bank charges for funds clearly borrowed to cover current operating costs.

- Interest on approved capital expenditures can be incorporated into rent increases as passed through to tenants.

- Increases in financing costs which did not result from a recent purchase of the residential complex can be passed through. Increases in financial costs which result from a recent purchase are recognized in the computation of the financial loss and can be covered partially by higher rents (up to 5% in one year) approved to reduce or eliminate the financial loss -- this was the substance of the 1982 amendments following the Greymac/Seaway Trust affair (see Corcoran and Reid, 1984).

- Charges reflecting corrections for past errors in projecting costs may be passed through. These corrections apply only if rent reviews are conducted in sequential years. Therefore, it is beneficial for a landlord to simply take the statutory rent increase in the years after an error in projections.

- All financial losses (negative cash flows) resulting from normal operations can be passed through. The pass-through of financial losses incurred on the purchase of the property will be spread gradually over a period of time with a maximum of 5% of total rents.

- When a financial loss is allowed and the financial position of the complex is raised to a "break-even" point, the landlord also qualifies for relief by means of a "hardship" allowance as described above. Also, a landlord whose gross revenues do not exceed his costs by at least 2% may be allowed an increase to reach that level of net revenues.
- Maintenance and repair costs can be passed through to tenants.
- Capital expenditures pass through as follows: the Residential Tenancy Commission, after determining the cost of an asset, by reference to a schedule of life expectancies, determines its useful life. The capital cost is treated as a debt payable over that period, and the permitted annual increases represent the imputed blended payments consisting of principal amortization and interest payments based on the average interest rates expected over the asset's life. The interest rates used are at the discretion of the Commissioners.
- There are no specific constraints on capital expenditures. Tenants may not object, so long as the expenditure has been incurred and the amount paid was legitimate.
- Tenants can complain about lack of appropriate maintenance or erosion of services during rent review hearings or when objecting to statutory increases. [S.132]
- The "cash flow" concept is the basis for the determination of rent increases above the statutory rate. (The cash flow considers the return of capital, i.e., mortgage principal payments, as an expense.) Provisions are made to reduce the incentives for rent increases through the sale of a building or by refinancing. The system which permits a landlord to initiate rent review with myopic horizons may result in the exploitation of cyclical cost behaviour, i.e.,

landlords requesting rent reviews when costs accelerate and take the statutory rent increases in other years.

- Opportunity costs are not recognized by the cost pass-through system. The sale of a building provides a means for gradually moving toward an economic return on capital invested as long as the financing of the unit keeps it highly leveraged and the financial losses resulting are small enough so that their recapture is not constrained by the 5% limit imposed by the 1982 amendments.

(e) Frequency of Rent Increases

- "The rent charged for a rental unit shall not be increased more than once in any twelve-month period." [S.124]

Earlier Legislation Regarding Frequency of Increases

- Amendments made in April 1976 were designed to provide additional protection to tenants against too-frequent rent increases by preventing multiple rent increases within a one-year period without justification. Rent increases could be imposed on any unit only once in a 12-month period.

(4) Rules Restricting the Removal of Units from the Controlled Stock

- The rules that specify how a rental unit may be decontrolled are set out in the Ontario Landlord and Tenant Act, not the Residential Tenancies Act which is silent on the subject. Before a landlord can convert a controlled rental unit into a condominium, renovate a unit or demolish a unit, he must first obtain legal possession. The rules under which a landlord may gain possession of a rental unit are set out in the Landlord and Tenant Act.

- A landlord can terminate a tenancy at the end of the tenancy agreement for the following reasons:

(i) Where the landlord bona fide requires possession for the purpose of occupation by himself, his spouse, or a child or parent of his or his spouse. [S. 105] Here the minimum notice is 60 days in all cases.

(ii) Where the landlord requires possession for the purposes of demolition, conversion to a use other than rental residential premises, or repairs or renovations so extensive as to require a building permit and vacant possession. [S. 107] Here the minimum notice is 120 days in all cases. In this case, where the reason is renovation the tenant has a right of first refusal once the unit has been renovated. The notice of termination by the landlord is not valid unless the tenant vacates or unless the landlord applies for a writ under S.113 within 30 days of the proposed termination date. A judge shall not issue a writ unless he is satisfied the landlord has met the conditions "and has obtained all necessary permits or other authority required ...." This provision gives local governments an opportunity to constrain the landlord's ability to terminate as per S.107. See the discussion in Chapter 6 regarding the City of Toronto's efforts to prevent demolition of rent controlled units.

- Section 121 of the Landlord and Tenant Act provides that a judge may refuse to grant a writ of possession, "unless he is satisfied, having regard to all the circumstances that it would be unfair to do so". He may also postpone enforcement of the writ for up to one week. In addition, a judge shall refuse to grant an application for a writ of possession where he is satisfied that:
  - the landlord is in breach of his responsibilities under the Act or "any material covenant in the tenancy agreement"; or
  - a reason for the application is that the tenant has (i) complained to a governmental authority regarding a health or safety standard, or (ii) attempted to secure or enforce his legal rights, or (iii) the tenant is a member of a tenants' organization or is trying to organize one; or
  - a reason is that the premises are occupied by children (provided there is no over-crowding and the premises are suitable for children). This would appear to mean that tenancy agreements barring children cannot be enforced on that point.

(5) Other Rules

(a) Tenant's Security of Tenure

- Many of the most important security of tenure provisions now in the Ontario Landlord and Tenant Act were brought into effect on January 1, 1970, following the Ontario Law Reform Commission's Interim Report on Landlord and Tenant Law Applicable to Residential Tenancies in 1968. These changes can be grouped into four categories:
  - statutory provisions concerning the tenancy agreement;
  - rules governing security deposits;
  - the abolition of old doctrines; and
  - rules governing the termination of tenancies during a lease and at the end of a lease. [For more details, see Stanbury (1985a, Ch. 3).]
- Security of tenure provisions are a necessary complement to rent controls for several reasons. First, tenants must be protected against "retaliatory eviction" following their efforts to make use of relevant legislation. Second, non-economic eviction must be prevented except under well-specified conditions. Third, security of tenure provisions are needed to prevent rental units from "escaping" from the controlled stock by means of conversion, demolition or re-conversion. Fourth, landlords must be prevented from practising non-economic discrimination whereby they are able to obtain "better quality" tenants, i.e., those less costly to serve or that more closely match the landlord's tastes and preferences.
- At the same time as it enacted the Residential Premises Rent Review Act in December 1975, the Ontario legislature passed a series of amendments to the Landlord and Tenant Act. The important changes included the following:
  - the notice of termination of all types of residential tenancies must be in writing and must specify the reasons and particulars of termination.

- the periods of notice were lengthened;
- the bases for a landlord to terminate a tenancy at the end of a tenancy agreement were carefully spelled out - see (4) above;
- the bases for a landlord to terminate a tenancy agreement before the end of a tenancy agreement were clearly spelled out;
- the bases under which a judge may grant a writ of possession were amended to specify conditions where he shall refuse to issue a writ and to provide that he may refuse to issue a writ "unless he is satisfied, having regard to all the circumstances, that it would be unfair to do so"; and
- an amendment to what is now S.121(4) provided that a landlord shall not withhold reasonable supply of any vital service such as heat, fuel, electricity, gas or water that it is his obligation to supply under the tenancy agreement or harass a tenant with the object of getting the tenant to vacate or to refrain from asserting any of his rights under the Act or the tenancy agreement. [See Stanbury (1985a, pp. 3-20 to 3-24).]

(b) Tenant's Property Rights in Their Unit

- The legislation currently in force does not contain provisions that outlaw "key money" or subletting for more than the prescribed rent. However, the original 1975 legislation made it a criminal offence for landlords to charge key money or to charge a rent higher than the lawful rent. However, we note that key money appears to be implicitly condemned if it was constructed as part of the rent charged by the landlord or by a tenant to a sub-tenant who is also considered to be a landlord. In these circumstances the amount of rent charged would be deemed to exceed the 6% guideline/statutory rate.

(c) Tenant Protections

- Any person may, without let or hindrance, organize or participate in an association the purpose of which is to secure and enforce the rights established by the Residential Tenancies Act. [S.122]

- Any person who ... harasses a tenant for the purpose of forcing the tenant to vacate or abandon a unit ... and every officer or director of a corporation who knowingly concurs ... is guilty of an offence and on conviction is liable to a fine not exceeding $2000. A corporation, if convicted, can be fined up to $25,000. [S.123]

- The Commission, in undertaking a whole building review in response to a landlord's application for a rent increase, shall determine the total rent increase ... that is justified by, inter alia, its findings concerning an improvement or deterioration in the standard of maintenance and repair of the residential complex or any rental unit located therein. [S.131]

- A tenant who desires to dispute any intended rent increase for his rental unit may apply to the Commission for an order requiring the landlord to reduce the amount — except where the increase does not exceed the maximum approved by the Commission. [S.127]

- A deposit paid by a tenant will be applied only in payment for the period immediately preceding the termination of a tenancy. The landlord must pay anually to the tenant 6% interest on deposits held by the landlord.

- The rights of association of tenants are guaranteed.

- Landlords are required to give notice in writing of 90 days for rent increases, including the statutory increase.

3.2 Administrative Characteristics

(1) Organizational Structure

- The Minister of Consumer and Commercial Relations is the minister responsible for Ontario's system of rent regulation.

- The Minister is empowered to establish regions in Ontario for the purposes of the Act. All proceedings will be held in the region in which the residential complex is situated unless the parties agree in writing or the Residential

Tenancy Commission directs. [S.86, S.87] Nine regions have been defined - see Regulation 902 to the Act.

- All expenses incurred and expenditures made by the Residential Tenancy Commission are paid out of funds appropriated by the Legislature. [S.88]
- Authority to administer the Residential Tenancies Act is vested in the Residential Tenancy Commission [S.81].
- Commissioners under the Residential Tenancies Act
  - are appointed by the Lieutenant Governor in Council (LGIC), i.e., the Cabinet,
  - have a term of office not exceeding five years, but may be reappointed for successive terms,
  - may be removed from office only for misbehaviour or inability to perform their duties,
  - need not work for the RTC on a full time basis, and
  - may be appointed as Appeal Commissioners by the Lieutenant Governor in Council (LGIC).[S.71, 72, 73, 76]
- The LGIC, i.e., Cabinet, appoints a certain number of Commissioners as members of the Board of Commissioners [S.77]. The Board of Commissioners is headed by the Chief Commissioner with members including three regional commissioners, four appeal commissioners and two officials of the Ministry of the Attorney General. The Board has developed quite elaborate Rent Review Guidelines which are practically the only source of information for the public regarding procedures under and interpretations of the 1979 Act.
- The Chief Tenancy Commissioner is the chairman of the Board of Commissioners and chief administrative officer of the RTC.[S.78]
- As of March 31, 1984, there was a Board of Commissioners consisting of 26 Commissioners, 18 Appeal Commissioners and three Regional Commissioners. (In the policy document Assured Housing for Ontario released in December 1985 the

government announced a number of changes in the operation of the RTC. See Stanbury & Thain, 1986, Ch. 9.)

Earlier Legislation on the Structure of the Regulatory Body

- The Residential Premises Rent Review Board was established by Section 12 of the Residential Premises Rent Review Act of 1975. The Board was composed of 53 members, of whom 29 were designated (in the words of the Act) "representative of tenants" while the remaining 24 were undesignated. Adjudicative powers were conferred only on the Rent Review Officers of the Residential Premises Rent Review Board. No provision was made for appeal of the Board's decision to the courts on a question of law, and no provision was made to enable the Board to to rehear an appeal.

- The 1979 Act made changes that went to the root of the regulatory process. It established a tribunal (the Residential Tenancy Commission) to take over the administration of the new Act, with quasi-judicial and broad discretionary powers. The 1979 Act discontinued the earlier practice of appointing members who were representative of tenants.

(2) Scope of Responsibilities

Overview: The role and functions of the Ontario Residential Tenancy Commission can be outlined as follows:

- The Residential Tenancy Commission has the authority to review all proposed rent increases upon application by landlords and tenants, and to establish the maximum rent which may be charged for a unit.
- A landlord seeking a rent increase, however small, is required to provide tenants with written notice 90 days prior to the effective date of the rent increase. Rents may not be increased more than once in any twelve-month period. The Commission's approval is necessary for rent increases above the guideline ceiling (statutory increase), currently 6%.
- When an application for rent increase greater than 6% is made by a landlord under the concept of "whole building review", rents for all units in a

building are reviewed at the same hearing although increases for different units may take effect at different times.

- The Act requires informal mediation as the first step in resolving rent disputes from tenant applications. Unsuccessful mediations are resolved through the formal hearing process.
- A rent review hearing is held before a single Commissioner who is expected to exercise independent judgement in rendering a decision. Any material filed with the Commission may be examined by all parties before or at the hearing.
- Landlords or tenants may appeal an order from the initial hearing to an Appeal Panel consisting of two Appeal Commissioners and a member of the Board of Commissioners. The decision of the Appeal Panel is considered final on questions of fact. However, questions of law may be brought before the courts. [Residential Tenancy Commission, 1983/84 Annual Report, p. 5.]

- The duties of the RTC as specified in the legislation are as follows:
  - to perform the duties assigned under the Residential Tenancies Act and its regulations - these consist primarily of receiving, hearing and adjudicating applications from landlords to increase rents or from tenants to prevent or reduce such increases.
  - to advise and assist the public on all residential tenancy matters including referral where appropriate to social services and public housing agencies;
  - to recommend amendments or revisions to the Act and its regulations;
  - to take an active role in ensuring that landlords and tenants are aware of the benefits and obligations established by the Residential Tenancies Act; and

- to prepare periodically and publish a summary of significant decisions of the Commission and the reasons therefore. [S.81]

- The RTC has the exclusive power to determine whether the Act applies to a particular living accommodation and the units to be included in a particular residential complex. [S.84]

- The RTC has the power to act as a binding arbitrator in disputes not within the jurisdiction of the Commission if it has the written consent of the parties [S.85].

- Except for an application for a Whole Building Review, the Commission is required to inquire into each application and to assist the parties in attempting to settle the matter by agreement (mediation). A Commissioner is not disqualified from holding a hearing only by reason that he sought to mediate the dispute. [S.102]

- First level hearings are conducted by a single Commissioner.

- The RTC is required to file with the Minister an annual report on its activities and the Minister must table the report in the Legislature promptly [S.91].

- The Commission has published a number of "short, simple brochures on rent review and landlord-tenant legislation":
  - "Rent Review: Here Are The Facts";
  - "Appealing a Decision, Its a Matter of Facts";
  - "Your Rights and Obligations under the Landlord and Tenant Act, Part IV (Residential Premises)";
  - "A Guide to Whole Building Review Hearings";
  - "A Guide to Tenant Applications."

- The Commission from time to time publishes Interpretation Guidelines. These "reflect views of the Board of Commissioners with respect to the manner in which certain key provisions in the legislation should be interpreted and applied. They are not intended to, nor do they in any way restrict the discretion of the Commissioner where the Act gives him/her discretion or where he/she has a different view of the meaning of the Act" (1983/84 Annual Report, p. 10). By March 1984, the Commission had issued 17 Procedural and 18 Rent Review guidelines covering more than 200 pages.

- The Commission has developed a Procedure Manual "designed primarily for the use of Commission staff." However, a copy is available for public perusal in any of the Commission's 21 field offices. It "describes in detail the manner in which applications and supporting documents are received and processed in the field offices. It also describes mediation and appeal procedures, conduct of parties at hearings, and such administrative matters as record schedules and management information reporting" (1983/84 Annual Report, p. 11). The forms used by the Commission are available in both English and French.

- The Commission publishes a "Guide to the Cost Revenue Statement." It provides detailed steps on how to complete the Cost Revenue Statement "necessary for applications by landlords for a rent increase above the statutory rate of 6%." During 1983/84, "a complete revision of this booklet was undertaken primarily in response to changes in policy guidelines and legislation," e.g., the 1982 Interim Act.

- In April 1984, the fourth volume of the Commission's Summary of Significant Decisions was issued by the RTC. "Cases selected for publication include decisions made by individual Commissioners at initial hearings as well as decisions made by Appeal Panels of the Commission" (1983/84 Annual Report, p. 11).

Earlier Legislation Regarding the Regulator's Scope of Responsibilities

- The regulator under the 1975 Act was not given the authority generally to advise and assist the public on all residential tenancy matters to ensure that landlords and tenants understand their respective rights and obligations.

- Nor did the 1975 Act make overt provision for the mediation of rent disputes. This provision, enacted in 1979, does not affect whole building review applications, hence it affects mainly tenant applications. The mediation process can eliminate the expense of lengthy formal proceedings.

(3) Procedural Matters

- All policy guidelines and procedural manuals issued by the Commission which may be used in making determinations under the Residential Tenances Act must be made available for examination by the public.[S.82]

- The RTC is required to "adopt the most expeditious method of determining the questions arising in any proceeding that affords to all persons affected ... an adequate opportunity to know the issues and be heard on the matter".[S.92]

- Landlords and tenants making an application to the RTC must send a copy to the affected tenants and landlord respectively.[S.98]

- There are formal rules specifying what constitutes a required notice or document.[S.99]

- All parties to a proceeding under the Residential Tenancies Act are entitled to examine all material filed with the RTC. [S.106]

Earlier Legislation Regarding Procedural Matters

- Subsection 7(3) of the 1975 Act set out the powers of a Rent Review Officer and provided that he must give a copy of his order together with written reasons to all parties who appeared at the hearing.

- Section 13(2) of the 1975 Act stated that a tenant, when appealing to the Board, should give notice of the appeal to all other parties who were entitled to appear at the original hearing. The time for giving notice of appeal was 30 days after the filing of the notice with the Board. The time for filing an appeal with the Board was 15 days.

- Section 6 of the 1975 Act provided that a landlord seeking an increase in rent shall, with the notice of a rent increase, supply the tenant with a notice of justification.
- A new provision in the 1977 amendments, subsection 11a, required a landlord to provide a rental history of premises to a rent review officer where he was so requested in writing.
- Under the 1977 amendments, landlords were required to provide tenants with written reasons for proposed rent increases above the statutory rate of increase.
- Amendments to the 1975 Act made in 1976 provided greater security to tenants through the application of a 12-month minimum period for the duration of an order of a Rent Review Officer or the Residential Premises Rent Review Board.

(4) Adjudicatory Characteristics

- The objectives of the Residential Tenancy Commission are clear -- to administer the Act. The objectives are interpreted and articulated by the decisions made during appeals and are incorporated into the guidelines developed by the Board. The structure of the Commission and the publication of Interpretation Guidelines increases the consistency of its decisions.
- Each decision of the RTC is to be made "upon the real merits and justice of the case", i.e., it may disregard the outward form of transactions and consider the pattern of activities relating to a residential complex. [S.93]
- The Commission is required to question the parties in attendance at the hearing or any witnesses with a view to determining the truth concerning the matters in dispute. [S.107]
- The onus of proof varies depending on the particular issue. Generally the party who raises an issue has the onus of proof with regard to that issue.
- Decisions can be made retroactive, especially when tenants request education in rents which were increased without rent review.

(5) Information Requirements

- No central rent registry exists at this moment, although Commissioner Thom (1984, Ch. 17) has recommended that one be established.
- There is no obligation at this moment for landlords to publish a rent schedule. (Section 33 that was not proclaimed provided for a registry and preparation of a rent schedule to be available for examination.)
- All parties to a proceeding under the Act are entitled to examine, and the Commission shall make available for examination, all materials filed with the Commission relevant to the proceedings.

(6) Bases of Initiation of Action by the Regulator

- Both landlords and tenants at the time of the conduct giving rise to an applications may make application to the Residential Tenancy Commission [S.95]. The Commission may authorize one or more persons to represent all those persons with a common interest in respect of an application.
- Landlords initiate proceedings where they request an increase above the statutory rate of increase. Tenants may initiate a hearing in objection to a statutory increase and can object to landlord's request for an increase above the statutory rate. Either the landlord or tenant can appeal a decision of a commissioner.

(7) Appeals

- Any party to an application, within 15 days of receiving the decision of a Commissioner, may appeal the decision by filing the proper notice and sending a copy to the other relevant parties. [S.117]
- The grounds for appeal to the Appeal Panel of the RTC include questions of fact or questions of law or a combination of both fact and law. [This point is not clear from the Act itself, but is set out in Procedural Guideline P-2.]

- Appeals are heard by a panel composed of two Appeal Commissioners and one member of the Board of Commissioners, non of whom took part in the decision being appealed. [S.117]

- The findings of fact set out in the reasons for the decision or order being appealed may be taken as true unless, within seven days of the filing of the notice of appeal, a party to the appeal objects and files the appropriate form indicating the facts with which he disagrees and those he intends to prove at the appeal hearing.

- Evidence at the appeal hearing is limited to proving facts referred to above. [S.117] See Thom (1984, Ch. 8). However, it is customary to admit evidence of further facts arising since the date of the original hearing, particularly as they relate to the accuracy of financial projections made at that hearing and comparisons of the projections with actual results.

- The appeal panel may decide on its own motion to rehear an appeal where, in its opinion, there has been a serious error...[S.117]

- The Appeal Panel may affirm the decision or order of the Commissioner, or substitute its own opinion and make a new order.

- The appeal procedures in the 1979 Act shortened the delay since they eliminated the requirement of proceeding with the second hearing de novo. The confusion of the procedures and inconsistency in approach appear to have increased the delays. The delays range now up to five months. See Table 5-4.

- Appeals of a decision or order of the Commission, are made to the Divisional Court only on questions of law. Such appeals are by stated case and the RTC is entitled to be heard on appeal to the courts. [S.118] The effect of this provision is to severely limit the number of appeals and to similarly limit their likelihood of success.

- The Divisional Court may
  - affirm, rescind, amend or replace the decision or order,
  - send the case back to the RTC for amendment and deliver judgment after it has been amended, or
  - remit the matter to the RTC with its own opinion, and
  - may make any order it considers proper and any order with respect to costs it considers proper. [S.118]

- The senior legal counsel for the Residential Tenancy Commission (in a latter to the Commission of Inquiry, dated May 3, 1985) states that some 166 orders or decisions of the RTC have been taken to judicial review or appealed to the Divisional Court. These 166 matters represent 86 court hearings. Of the 13 cases heard and decided: 3 appeals were allowed and the matter was remitted back to the RTC for a new hearing on defined issues; 1 application for judicial review was allowed (the decision was quashed); and in 9 cases the appeal was dismissed. In 51 cases the appellant discontinued the appeal, it was dismissed by the Registrar as abandoned or it was quashed by Court Order.

(8) Enforcement

- "The Commission may include in any order terms and conditions it considers proper in all the circumstances." [S.110]

- No tenant is liable to pay any rent increase in excess of that permitted to be charged under Part XI of the Residential Tenancies Act (rent review). [S.129]

- Procedural Guideline P-6 states that "an order setting a maximum rent for a rental unit is self-enforcing: the tenant can simply refuse to pay more than the amount specified in the order."

- The tenant may have to take other steps to enforce an order under S.129 requiring a landlord to repay excessive rents. If the tenant is still a resident of the unit affected, he may seek an order under S.114(1) whereby he may deduct a specified sum from his rent for a specified number of rent payments. Alternatively, if the tenant has moved, he can use the court system to collect the debt by filing the RTC's order with the county or district court. See Procedural Guideline P-6.

- A certified copy of an order of the Residential Tenancy Commission for the payment of money may be filed with the Supreme Court or with a county or district court and, on being filed, has the same force and effect as if it were a judgment of that court.[S.115]

- The RTC is limited in the amount of money it can order re-imbursed to $3000 although a tenant, for example, may institute proceedings in the courts if his claim exceeds $3000. The RTC may, however, arbitrate with written consent a dispute that may involve an award of more than $3000. [S.84]

- An individual who (i) fails to obey an order of the RTC, (ii) knowingly furnishes false information to the Commission, or (iii) harasses a tenant for the purpose of forcing the tenant to vacate - upon conviction - may be fined up to $2000. In the case of a corporation, the maximum fine is $25,000. [S.123]

- We note that there is no penalty for a landlord who overcharges on rent, i.e., effects an illegal rent. However, rents in excess of the legal rent may be rolled back by the RTC and an order made requiring that a refund be paid to tenants.

- We note also that there is no penalty that can be imposed on a tenant who knowingly enters into an arrangement involving an increase in rent that would result in an illegal rent. Indeed, a tenant could enter such an arrangement then later apply to the RTC to obtain a refund of the excess rent he had knowingly agreed to pay.

- The practice of tenants subletting and charging "key money" or more than the lawful rent was not dealt with in the 1979 Act which is the one presently in force. This seems rather peculiar in light of the legislation's emphasis on controlling the rent of the unit rather than only that of the sitting tenant. However, where a tenant sublets his controlled unit he may be construed to be a landlord under the Act and hence be subject to the legal limits on rent increases. As a practical matter, however, it strikes us that the change made in the 1979 Act to remove the offence re subletting amounts to favoring tenants over landlords.

Earlier Legislation Regarding Enforcement

- The 1975 Act specifically made it an offence for a landlord to charge more than the statutory increase (then 8%), to charge a rent increase to take effect within less than a year after the last increase, to collect more than the maximum rent chargeable under an order of the Rent Review Officer, to refuse to file a multi-unit application for rent review when so ordered, and to knowingly furnish false information. Under the 1975 Act, a breach of these rules was an offence punishable by a fine.
- The practice of tenants subletting and charging "key money" or more than the lawful rent is not dealt with in the 1979 Act.
- Only one of the criminal offences contained in the 1975 Act, to knowingly furnish false information, was carried into the 1979 Act. However, it was made a criminal offence to violate an order of the Commission or harass a tenant for the purpose of forcing him to vacate.

4.0 CHANGES IN RENT REVIEW, 1985*

On December 16, 1985 the Minister of Municipal Affairs and Housing published a position paper entitled Assured Housing for Ontario. In his speech accompanying the policy statement the Minister stated that his program was based on five main elements:

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* This section is taken from Stanbury & Thain (1986, Ch. 9.)

- First, a fair and effective system for protecting the rights of tenants;
- Second, a policy of equitable treatment for owners of rental property, in a climate of increased confidence;
- Third, prompt mesures to meet essential housing needs, with the government assuming an active role;
- Fourth, a commitment to a dynamic, efficient building industry which will continue to be a major source of employment in Ontario; and,
- Fifth, an era of improved cooperation and conciliation among governments, producers and consumers of housing throughout this province. (Curling, 1985, pp. 4-5).

With respect to rent review, Assured Housing for Ontario contained the following proposals:

- Creation of a Rent Review Advisory Committee of landlords and tenants to provide advice to the Housing Minister (the co-chairpersons are Mary Hogan, director of the Parkdale Community Services - which represents tenants, and William Grenier, chairman of Pagebrook Holdings, and head of a landlord's association);
- Reduction of the guideline or statutory rate of increase from six to four per cent effective August 1, 1985 for a period of one year;
- Inclusion of units built after 1975 under rent review;
- Expansion of rent review legislation to cover units renting for more than $750 per month;
- Creation of a rent registry as recommended by Commissioner Thom (1984) (to be based on rents in effect July 1, 1985);
- Extension of five per cent maximum refinancing cap (effective in 1982) due to expire at the end of 1985;
- Introduction of a costs-no-longer-borne provision (i.e., reduction in mortgage interest rates);
- Introduction of a provision to allow for the elimination of economic losses for units constructed after 1975;
- Restructuring of the Residential Tenancy Commission to provide for a new non-adversarial system of rent review;
- Creation of a network of rent review advisors to handle rent review applications;
- Creation of a Rent Review Hearings Board to hear appeals of rent decisions;
- Creation of an inter-ministerial committee to examine ways to assist needy tenants and to assist pre-1976 landlords charging chronically reduced rents; and

- Creation of a committee to study the best methods of protecting boarders and lodgers (summary provided by Ministry of Housing, 1985).

The new policy document illustrated the public sector costs of rent control in the form of subsidies of various types to create more new rental unis. In summary, the various "housing initiatives" will costs the Province in more than $500 million over the next five years. Subsidies will support production or more than 43,000 new rental units: 32,000 social housing and a total of 11,000 market units.

The major items to be included in legislation that were optimistically "expected to be enacted before Christmas" were the following:

- reduction of the statutory rate of rent increases from 6% to 4% retroactive to August 1, 1985; this rate to apply until August 1, 1986;
- extension of controls to units renting for $750/month or more;
- extension of controls to buildings first occupied after January 1, 1976 (previously exempt from controls); and
- placing a cap of 5% on rent increases attributable to refinancing following the sale of a building.

Three of these four items were in fact included on Bill 77 which was introduced later in December.

Mr. Curling made a clear long-term commitment to rent regulation by saying that as of 1987 the rent increase guideline (statutory rate) will be tied to inflation: "The guideline will be set annually at a rate linked to, but not as high as the rate of inflation." The delicate balancing of interests was evident in Mr. Curling's statement to the effect that landlords of older buildings who are "locked into chronically depressed rents" will be able to go before a committee set up by the government to obtain "more realistic rents" -- without passing on the increases to tenants who cannot afford them (see Ontario Ministry of Housing, 1985b, pp. 7-9).

Editorially, the Globe and Mail (December 17, 1985) condemned the Minister's policy proposals saying he had "galloped off in the wrong direction", and that his proposals "will drive the stake of rent control deeper into the heart of the province's rental housing market..." The Minister's document, the Globe and Mail noted identified a number of the problems associated with the present rental housing market: chronicallay low vacancy rates; declining standard of maintenance in some buildilngs, a lack of capital improvement in others; increasing acrimony between landlords and tenants; and "the virtual collapse of new rental construction." In the Globe's view, these are all attributable to rent controls. The editorial concluded as follows:

> The Government refers to its fiddling, some of which will temper the injuries done by rent control, as 'reform'. It will not concede that the best reform would be to phase out controls gradually, provide shelter allowances for those who need tham and encourage the market to supply new units to meet an overwhelming, frustrated demand.

5.0 THE ADMINISTRATION AND EVOLUTION OF RENT REGULATION IN ONTARIO, 1975 - 1984

The Ontario Rent Review Program came into existence on December 18, 1975 with the passage of the Residential Premises Rent Review Act. Legislation was retroactive to July 29, 1975 and was to expire August 1, 1977. Officially, the program was conceived in part as Ontario's contribution to the federal Anti-Inflation Program (see, for example, Thom, 1984, p. 7). However, Stanbury and Thain (1986) show that rent control was the product of a closely fought election campaign preceded by considerable agitation for controls by the NDP, local politicians and tenant groups. In terms of implementation, two ministries were originally involved in establishing the Rent Review Program: the Ministry of Consumer and Commercial Relations and the Ministry of Municipal Affairs and Housing. However the former ministry became solely responsible for rent review in 1976.

By February 29, 1976, the regulators had received applications for rent review representing 214,971 units. Requests were made for rent increases above the statutory 8% level by landlords representing 206,432 units while 8,539 were applications submitted by tenants. In the remainder of the year, some 9,413 review hearings were held. The average rent increases requested by landlords applying were 19.7% while Rent Review Officers awarded an average increase of 12.6%. See Table 5-1. For more detail, see Table 5-2.

To ensure coordination of the Rent Review program with other provincial housing related programs and policies, an Executive Support team was established under the direction of the Executive Director. The group maintained communications with other branches in the Ministry of Consumer and Commercial Relations and other ministries. The total cost of the first year of operations (1976/77) was $8.5 million.

The Residential Premises Rent Review Board was established to hear appeals of decisions by the Rent Review Officers. The Board consisted of 53 members of whom 29 were "representative of tenants". The chairman was a full-time member, while the other members were part-time paid on a per diem basis. Few of the members had legal or accounting training. The Board sat in panels of two, of which one was a designated tenant representative. Board decisions were final and subject only to judicial review. The appeal was de novo, i.e., a re-hearing rather than an appeal in a narrow sense. The Board received 28,514 notices of appeal constituting about 16% of all decisions (90% of the appeals were by landlords).

During 1977, applications for rent review representing 55,903 units were made, of which 94% were for rent increases by landlords. Landlords requested increases averaging to 18.1%, whereas Rent Review Officers granted average increases of 12.2%. In 1977 landlords in buildings incurring financial losses constituted 46.6% of the applicants for rent review. Most landlords chose rent increases within the guidelines. See Tables 5-1 and 5-2.

The rent review program was to expire on July 31, 1977, but on April 29, 1977, amendments to the Act extended it to December 31, 1978.

Effective October 27, 1977, the statutory increase was reduced from 8% to 6%. This reduction caused a significant increase in applications for rent review in the last quarter of 1977.

An inter-ministerial committee from the Ministry of Consumer and Commercial Relations, Municipal Affairs and Housing, and the Attorney General was formed to develop policy options. The green paper Policy Options for Continuing Tenant Protection was released in February 1978.

The Residential Premises Rent Review Act was amended also to permit the Board to reconsider a decision within a short period after issuing an order. Previously, Board decisions were final and only the courts could instruct the correction of an error. Parties who did not take part in the first hearing were permitted to appeal to the Board. This provision appeared to be in favour of tenants, since most first instance hearings were at the request of the landlord. During the year, reflecting the decrease in volume, the number of Board members declined to 32.

The last full year under the Residential Premises Rent Review Act was 1978. New legislation was drafted after extensive consultation and discussion.

In 1978 some 37,897 applications for rent review were received, of which 95% were from landlords seeking rent increases above the 6% limit. Most hearings were initiated by landlords of large buildings. For 48.5% of all the units involved in the hearings, a financial loss was documented. Similar capital expenditures were cited in 67% of all units involved in the hearings. In their applications, landlords sought an average increase of 15.7% but Rent Review Officers granted on the average 9.6%. In 1977/78, the total cost of administering the rent review program was $5.2 million.

Bill 163, the proposed Residential Tenancies Act, was introduced in the Legislature on October 30, 1978. On December 1, 1979 the provisions of part XI of the Residential Tenancies Act (rent review) took effect. In the first nine months of the year 17,623 applications were received, of which 92.6% originated from landlords. This was a significant reduction in volume from the 36,017 and 30,038 applications received in 1977 and 1978 respectively. The pattern in the composition of users of the rent review system continued as before: landlords of large-number units, citation of financial losses (these increased from about 48% in 1978 to 60% in 1979), and capital expenditures. Indeed, the increasing trend of using the capital expenditure pass-through provisions appear to imply that at least in the case of large complexes, the pass-through provisions encouraged capital improvements.

The average request of applicants for rent review in 1979 were for 17.4% increases while Rent Review Officers granted average increases of 11.2%.

Major changes in legislation took place in 1979. In June, the Residential Tenancies Act was passed, but it was to come into force by proclamation. The sections dealing with the Residential Tenancy Commission were proclaimed on August 17, 1979. This Act sought to combine and reform rent review which was conducted under the Residential Premises Rent Review Act, and Part IV of the Landlord and Tenant Act. In August, the new Residential Tenancy Commission was established and within a month its first Commissioners were appointed. Many sections of the Act remained unproclaimed pending a reference to the Ontario Court of Appeal. It decided on February 21, 1980, that certain powers given to the Commission were unconstitutional. The Court of Appeal's decision was unanimously upheld by the Supreme Court of Canada on May 28, 1981. See the discussion in MacDonald (1984).

On June 23, 1978 an amendment simply extended the current legislation to February 28, 1979.

Under the new Act (1979 Act as it is called), the rent review hearings and appeals were placed under the administration of the Residential Tenancy Commission. Appeal panels were established, consisting of a member of the Board of Commissioners (the Executive Board) and two Appeal Commissioners. No representation on appeal panels was introduced.

The Board of Commissioners also was charged with the development of guidelines detailing reasonable approaches to the different situations which may be encountered. Subsequently, the Residential Tenancy Commission produced two sets of Interpretation Guidelines, procedural and substantive, covering more than 200 pages.

The first four months of operations under the new system resulted in a decline in the relative share of hearings initiated by landlords of large complexes.

An average increase requested by landlords was 14.3% and they were awarded average increases of 10.7%. Generally, landlords of small complexes received the largest increases. About 50% of the residential complexes reviewed by the Commission accrued a financial loss. Capital expenditures, both incurred and planned, figured in 78% of the applications. See Table 5-3. In 1980/81 the expenditures of the Residential Tenancy Commission amounted to $4.7 million.

In the 12 month period ending March 31, 1981 the Commission received 2170 landlord applications for whole building review involving 51,542 residential units. The Commission held 1607 hearings. Some 17% of the total hearings involved large complexes affecting 67% of the total rental units involved in hearings.

The Residential Tenancies Act permits tenants to dispute any rent increases (including those which fall within the 6% limit). Some 1649 tenant applications disputing rent increases were received in fiscal year 1980/81 and 1160 tenant applications requesting rebates on past rent overcharges. Some 367 of these disputes involving rent increases and 729 concerning rent rebates were resolved through mediation.

In fiscal year 1980/81 it took an average of 62 days between receipt of an application for a whole building review and the date of the hearing. Another 26 days on the average elapsed until the issuance of an order. More generally, see Table 5-4.

In the case of tenant application, the lag between an application and a settlement through mediation was 42 days if the mediation was successful and 104 days when hearing and a review decision followed when mediation was not successful. On average it took 113 days to process an appeal from the initial decision to the date of the appeal order. See Table 5-4.

In fiscal year 1980/81 landlords who applied for a review requested an average increase of 15.7% and were granted 11.6%. See Table 5-1.

The pattern of the composition of applications remained similar to past years. About half of all residential complexes participating in the rent review process incurred financial loss. The major change involved a doubling of the impact of increased financing payments reflecting the significant increase in interest rates.

Approximately 15% of all initial orders were appealed.

The higher mortgage rates resulted in an increase in the volume of work of the Commission. This trend continued in FY 1981/82. Interest rates reached a record of 22.75% in August 1981, leading to 132% increase in applications for rent review (affecting 157,811 units). Landlords applying for rent review requested increases averaging 19.3% and were granted an average of 14.7% increases. The relative importance of increased financing payment increased (1 out of 3 applicants cited it in his application). Higher operating costs, however, was the key factor in rent increases granted (6.7% out of the 14.7%). Financial loss was experienced by half of the applicants and two thirds of all applicants incurred capital expenditures on their buildings and sought to recover the appropriate annual pass-throughs.

In spite of the increased workload, the expenses of the Commission remained stable at $4.9 million in 1981/82. Four-fifths of all tenant applications were resolved through mediation. The increase in volume of applications resulted also in an increase of 49% in the volume of appeals. The increased volume and the tight budgetary control resulted in a deteriorating service. It took an average of three and a half months from the receipt of an application for a rent review to the issuance of an order. Similarly, the lags in resolving rent reduction applications by tenants increased to 57 days on the average when mediation was successful and to 103 days when a hearing eventually took place.

It took 144 days to process an appeal from the date of the initial decision. See Table 5-4.

Amendments were introduced to the Residential Tenancies Act which affected cost pass-through provisons. The Residential Complexes Financing Costs Restraint Act -- Bill 198 was passed in December 1982. It restricted financing cost pass-through resulting from a sale of a property to 5%. Several revised guidelines were developed. In particular, the Commission suggested in Rent Review Guidleline No. 4 that financial loss caused by new financing as a result of a sale should be passed through over a period of five years rather than three. It advised consideration of decreasing financing costs even when rent review does not take place. It did not permit a whole building consideration of interest on borrowing to finance any losses resulting from spreading or extended spreading of a financial loss. It restricted pass-through of financial loss where there has been more than one sale during the last three years.

The information and public advisory functions of the Commission were expanded by assimilation of the Landlord and Tenant Bureau functions into the rent review informaton services. See Table 5-4. The Commission also undertook active enforcement of its orders including assistance with some prosecutions.

The budget of the Commission was increased and its expenditures in fiscal year 1982/83 reached $6.5 million.

In fiscal year 1982/83 the Commission received 5442 landlord applications involving 189,957 rental units. The increase was especially marked in large unit applications. Sixty-eight percent of the units under review were in large complexes. The number of tenant applications disputing rent increases was 1279 and the number of tenant applications requesting rebates of past rent overcharges was 2474. Three quarters of all tenant applications were resolved through mediation. The number of appeals increased by 74% to 725. The service level declined further. In fiscal year 1982/83 it took an average of 6 months from receipt of an application to the issuance of an order in whole building reviews. It took on the average 66 days to resolve tenants' applications when mediation was successful and an average of 93 days when mediation was not successful. Appeal took six and one-half months to process from the date of the initial decision. See Table 5-4.

In fiscal year 1982/83 landlords requested an average increase of 20.9% and were granted an average increase of 14.2%. The high increases granted, as was the case in previous years, were in applications of owners with small complexes. The range of increases was wide (the majority falling between 6% and 30%). Higher operating cost pass-throughs were the key factor in rent increases (a claim present in 96% of the applications). As was the case in previous years, financial loss was experienced by half of all landlords who applied for rent review. The number of applications citing increased financing cost was doubled, again reflecting the prevailing high interest levels. The impact of this factor, however, declined slightly due to the decrease in interest rates toward the latter part of the year. Two-thirds of all applicants cited capital expenditures as part of their cost pass-through requests.

Fiscal year 1983/84 was characterized by a significant fall in the number of applications (from 5442 applications in the previous year to 2074). Similarly, the number of units covered fell from 189,952 to 76,839. The expendiutres climbed to $7,735,089 but because the inventory of applications outstanding from the previous year service levels deteriorated further. In FY 1983/84 it took an average of 7 months from the receipt of an application to issuance of an order in a whole building review. Tenant disputation of rent increases took 88 days to resolve when mediation was successful. In other cases an application took 172 days to be processed. Rent rebate applications took on the average 100 days to be settled through mediation. When mediation was not successful the total delay experienced averaged 167 days. Appeals took 217 days to process from the date of the initial decision to the date of appeal order.

Landlords requested an average increase of 19.7% and received from the Commission an average increase of 10.6%. See Table 5-1. A total of 3987 tenant applications disputing rent increases and for rent rebates were received. Three-quarters of these applications were resolved through mediation. The Commission assisted tenants in recovering from landlords approximately $1.2 milion in excess rents paid. FY 1983/84 was also marked by a more active program of enforcement.

The pattern of factors influencing rent increases reflected the decline in interest rates. While increases in operating costs were claimed in 97% of all applications filed by landlords, the proportion of applications involving increased financing costs dropped to 26%.

Capital expenditures were cited in 79% of all landlords' applications, accounting for 1.7 percentage points of the 10.6% average increase. See Table 5-3.

Financial losses were experienced by 48% of all applicants, identical proportions experienced over the past four years. See Table 5-3. The impacts of the financial loss factor and the hardship provisions were contained by the restrictions imposed by the Residential Complexes Financing Restraint Act.

The total cost of operating the Residential Tenancy Commission in 1983/84 was $7.7 million.

The 1982 Interim Act was to expire on December 31, 1983, but was subsequently extended one year at a time.

On November 15, 1984 a bill was introduced to extend the 1982 Residential Complexes Financing Costs Restraint Act until December 31, 1985. The government, also acting upon a recommendation in the Thom Report (1984, recommendation 58) temporarily revoked Regulation 900 under the Residential Tenancies Act, thus eliminating the exemption of units renting for $750 per month or more from rent controls.

Although the Residential Tenancy Commission began operation in late 1979, it was not until 1983/84 that it began to investigate and to prosecute offenders under the Residential Tenancies Act. In that year the RTC began 24 new investigations and completed 22 by year end. In eight cases charges were laid against 14 individuals and 9 corporations. There were three successful prosecutions during 1983/84 resulting in fines of between $1000 and $15,000 per case. Five investigations were still in progress at year end.

Rent review in Ontario may be more important to some tenants and landlords than to others. Earlier we argued that owners of many rental units and organizaed tenant groups will have lower transactions costs (per unit) in dealing with rent control, i.e., they will both benefit from economies of scale. Stanbury (1984a) also noted that the strongest agitation for controls in 1975 occurred in the Metro Toronto area. In the heart of that area, the City of Toronto, two-thirds of all households are tenants.

For both of these reasons we sought to determine if tenants and landlords in the Toronto CMA were more active participants in the rent review system. Three points of reference are necessary before we discuss the data in Table 5-5. First, Toronto CMA accounted for 41.5% of all rental units in Ontario in 1981. Second, Toronto CMA accounted for 62% of all rental units in buildings of more than six units in Ontario in 1981. Third, Toronto CMA accounted for 64.8% of rental units in buildings of twenty or more units in Ontario in 1981.

We found that, typically, 52% to 60% of units granted an increase above the statutory rate were in the Toronto CMA. In other words, in terms of total number of rental units in Ontario, Toronto CMA was "over-represented" among those successful in their rent review applications. We will note in Chapter 6 that small buildings are under-represented in rent review. Since the Toronto CMA accounts for 62% of rental units in Ontario, the data in the third column of Table 5-5 may not indicate the Toronto CMA is over-represented in rent review hearings for rent increases above the statutory rate.

The Toronto CMA accounts for 59% to 69% of all units going to appeal. Again, depending on the reference pont (all units or units in larger buildings), Toronto CMA may or may not be over-represented in the appeal process under rent review. The same comment applies to tenant applications for a rent rebate in Table 5-5.

By any measure, the Toronto CMA is "under-represented" in terms of the total number of inquiries made to the RTC or its predecessor, although in 1982/83 and 1983/84 inquiries from the Toronto CMA just equalled that area's proportion of all tenants in Ontario. It may be that landlords and tenants in the Toronto area are better informed about rent review precisely because they make more use of its formal procedures.

Table 5-1

Summary Statistics on Rent Review in Ontario, 1976 to 1984/85

	Jan-Dec 1976	Jan-Dec 1977	Jan-Dec 1978	Jan-Dec 1979	1979/80 (7 mos)	1980/81	1981/82	1982/83	1983/84	1984/85 ***
APPLICATIONS										
Landlords	206,432*	52,393*	36,104*	16,322*	987 26,374u	2,170 51,542u	5,027 157,611u	5,442 189,952u	2,074 76,839u	1,793 58,043u
Tenants	8,539	3,515	1,775	1,301	993	2,809	3,053	3,753	3,987	3,886
Review Hearings	9,413	5,145	3,804	2,101	760	1,781	3,369	5,224	3,784	2,551
Appeal Hearings	1,247	1,33 5,290u	617 5,914u	n/a	20	290	229	415	772	547
OVERALL RESULTS										
Hearings	7,317	3,541	2,768	1,428	609	1,404	2,751	4,202	2,742	1,399
Units involved	131,455	39,219	40,949	18,370	19,469	42,377	82,651	127,812	106,472	53,786
Rent Increase										
% requested	19.7	18.4	15.8	17.4	14.3	15.7	19.3	20.9	19.7	16.0
% granted	12.6**	12.5**	9.7**	11.3**	10.7	11.6	14.7	14.2	10.6	10.0

u = units

* apparently based on the number of rental units involved. The data for 1979/80 on give the number of applications and the number of units represented by the landlord applications.

** after appeal

*** preliminary results

Source: Compiled from the Annual Reports of the Residential Tenancy Commission and Ontario Rent Review Office (Toronto, various years).

Table 5-2

Results of Rent Review Hearings in Ontario Involving Various Types of Cost Factors, 1976 to 1984/85

	Jan-Dec 1976	Jan-Dec 1977	Jan-Dec 1978	Jan-Dec 1979	1979/80 (7 mos)	1980/81	1981/82	1982/83	1983/84	1984/85 **
FINANCIAL LOSS*										
Hearings	2,049	1,217	1,312	849	306	705	1,280	1,929	1,312	680
Units	37,896	18,278	19,866	11,424	8,985	17,881	36,991	45,270	39,919	22,003
% requested	20.5	20.2	17.5	18.4	15.9	18.0	22.5	24.7	22.9	17.7
% granted	15.6	14.7	11.5	12.7	12.5	13.9	17.6	17.8	12.6	11.0
CAPITAL EXPENDITURES*										
Hearings	3,138	2,219	1,806	975	472	1,028	1,838	2,870	2,169	1,193
Units	60,004	23,734	27,498	12,696	15,819	32,889	58,171	106,250	93,890	48,289
% requested	20.3	18.3	15.8	17.5	14.5	15.9	19.2	20.7	19.5	15.9
% granted	12.9	12.5	9.7	11.4	10.8	11.6	14.6	13.8	10.5	10.2
INCREASED FINANCING PAYMENTS										
Hearings	734	283	244	157	79	252	889	1,725	709	323
Units	14,495	3,113	4,593	1,820	3,622	10,817	27,348	43,920	27,353	15,284
% requested	21.3	20.9	14.6	14.8	14.1	15.0	22.0	23.5	22.1	16.3
% granted	13.6	14.3	10.9	9.8	11.2	12.1	18.0	17.3	13.3	10.7
INCREASED OPERATING COSTS										
Hearings	n/a	3,321	2,680	1,344	575	1,284	2,526	4,020	2,666	1,368
Units	n/a	38,009	38,860	17,575	19,237	40,275	77,725	123,141	105,354	53,523
% requested	n/a	18.2	15.3	16.8	14.1	15.3	19.0	20.8	19.6	15.9
% granted	n/a	12.4	9.5	10.8	10.7	11.4	14.7	14.1	10.6	10.0

* i.e., hearings in which a financial loss (or capital expenditure) was one of the reasons why an increase more than the statutory increase was requested.

** preliminary results

Source: Compiled from the Annual Reports of the Residential Tenancy Commission and the Ontario Rent Review Office (Toronto, various years).

Table 5-3

Importance of Various Cost Factors in Ontario Rent Review Hearings, 1979/30 to 1984/85

	1979/80		1980/81		1981/82		1982/83		1983/84		1984/85*	
Relevant Cost Factor	% of hear-ings	Impact on all applic	% of hear-ings	Impact on all applic	% of hear-ings	Impact on all applic	% of hear-ings	Impact on all applic	% of hear-ings	Impact on all applic	% of hear-ings	Impact on all applic
• Financial loss	50	2.3 21%	50	2.7 23%	47	3.3 22%	46	3.0 21%	48	1.7 16%	49	1.6 16%
• Capital expenditure	78	1.7 16%	73	1.6 14%	67	1.6 11%	68	1.5 11%	79	1.7 16%	85	2.5 25%
• Increased financing payments	13	0.8 8%	18	1.5 13%	32	2.8 19%	41	2.5 18%	26	1.3 12%	23	0.9 9%
• Increased operating costs	94	5.8 55%	92	5.5 47%	92	6.7 46%	96	7.0 49%	97	5.8 55%	98	4.9 49%
• Relief of hardship	11	0.3 3%	12	0.3 3%	11	0.3 2%	11	0.2 1%	8	0.1 1%	6	0.1 1%
All hearings	100%		100%		100%		100%		100%		100%	
# of hearings	609		1404		2751		4202		2742		1399	
Total increase (percent)		10.7		11.6		14.7		14.2		10.6		10.0

* preliminary results

Source: Completed from the Annual Reports of the Ontario Residential Tenancy Commission (Toronto, various years).

Table 5-4
Activity Measures by the Ontario Residential Tenancy Commission, 1979/80 to 1984/85

	1984/85 *	1983/84	1982/83	1981/82	1980/81	1979/80 7 months
INQUIRIES						
• Total number	305,788	311,881	271,151	172,749	122,224	35,552
• % by tenants	71.4	71	73	n/a	n/a	n/a
• % relating to the Landlord and Tenant Act	63.4	60	55	33	40	37
OUTSTANDING WORKLOAD AT YEAR END						
• Whole building review	412	566	1978	2034	457	282
• Tenant applications	1,237	1073	1349	690	430	235
• Appeal hearings	87	127	281	149	37	73
WHOLE BUILDING REVIEW ORDER ISSUED PRIOR TO EFFECTIVE DATE OF RENT INCREASE	13%	6%	5%	31%	54%	n/a
AVERAGE DAYS FROM APPLICATION TO ISSUE OF ORDER OR AGREEMENT						
• Whole Building Review	158	213	176	109	88	n/a
• Tenant rent reduction	132	110	74	66	55	n/a
• Tenant rent rebate	92	117	88	54	48	n/a
• Appeals	188	202	179	128	97	n/a
HEARINGS COMPLETED						
• Rent reduction	222	56	34	46	39	17
• Rent rebate	628	592	238	138	95	49
MEDIATED SETTLEMENTS						
• Rent reduction	138	204	199	407	367	140
• Rent rebate	1,906	2028	1213	796	729	760

* preliminary results

Source: Compiled from the Annual Reports of the Ontario Residential Tenancy Commission (Toronto, various years).

Table 5 - 5

Importance of Toronto CMA in Rent Review Activities, 1976 - 1983/84

	Number of Rental Units Granted an Increase			Number of Appeals			Number of Inquiries			Tenant Applications for a Rent Rebate		
Year	Toronto CMA *	Province	%	Toronto CMA *	Province	%	Toronto CMA *	Province	%	Toronto CMA *	Province	%
1983/84	57,160	106,472	53.9	13,165	21,028	62.6	133,691	311,881	42.9	1,636	3,135	52.2
1982/83	59,557	127,739	46.6	11,752	19,822	59.3	80,007	188,230	42.5	1,258	2,474	50.8
1981/82	45,679	82,650	55.3	7,088	10,944	64.8	60,990	172,749	35.3	943	1,585	59.5
1980/81	22,332	42,377	52.7	7,175	11,585	69.1	44,346	122,224	36.3	520	910	57.1
1979/80 (Dec.1 - Mar. 31)	12,059	19,469	61.9	n/a	n/a	n/a	10,619	35,552	29.9	891	222	40.1
1979 (Jan.1 - Nov. 30)	10,928	18,370	59.5	n/a	n/a	n/a	28,279	102,852	27.5	967	1,301	74.3
1978	27,177	40,949	66.4	n/a	n/a	n/a	39,205	95,740	40.9	613	1,775	34.5
1977	21,918	39,219	55.9	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
1976	68,653	131,455	52.2	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

* Includes data from Toronto, Etobicoke, North York, East York, Scarborough and Mississauga regional offices.

n/a = data not available

Source: Compiled from the Annual Reports of the Residential Tenancy Commission and Office of Rent Review (Toronto: various years).

Chapter 6

THE EFFECTS OF RENT REGULATION IN ONTARIO

1.0 INTRODUCTION

The Province of Ontario enacted rent regulation on December 18, 1975 retroactive to the end of July. Although the legislation was to be eliminated effective August 1, 1977 it was extended several times and in late 1979 it was both amended extensively and made "without term". In a few months, rent regulation will have been in place for a decade in Ontario and there are no signs it will be removed.

In light of the continued intense interest in such regulation by both landlords and tenants, the continued official support for it by all three political parties and the responsibilities of the Commission of Inquiry into Residential Tenancies, it is important to examine its effects. Therefore, the purpose of this chapter is to review the empirical evidence concerning the key economic effects of rent regulation.

In Chapter 3 we grouped the many possible effects of a system of rent regulation into three principal categories. We now summarize that framework and its major components and indicate on which of them we were able to assemble data on the effects of rent regulation in Ontario in Figure 6-1.

Obviously, we have not been able to obtain empirical evidence on all of the sub-categories of effects listed in Chapter 3. We have, however, been able to assemble data of varying quantity and quality on most of what we believe to be the key effects of rent regulation. These include the level and rate of change of rents; the price (market value) of rent controlled buildings; the supply of existing units (including both the "erosion" of the stock of rental buildings existing at the time controls were imposed and the changes in the

Figure 6-1

Classification of the Effects of Rent Regulation and the Evidence Available for Ontario

Types of Effects	Material on Effects in Ontario
1. Allocative Effects	
(a) Price effects	
• level and rate of increase in rents	• Section 2.0
• market value of rental buildings	• Section 3.0
(b) Quantity or supply effects	
• existing stock	
- removals from the stock under controls	• Section 4.0
- changes in the level of maintenance	• Section 5.0
• - supply of new units	• Section 6.0
(c) Vacancy rates - the balance between supply and demand in the rental market	• Section 7.0
2. Distributional Effects	• Section 8.0
3. Other/Secondary Effects	
(a) Government revenues and expenditures	
(b) "Tarbaby" effects	
(c) Non-price rationing	
(d) Psychological effects	
(e) Other behavioural effects	
• tenant mobility	• Section 9.0

quality/quantity of rental units attributable to changes in the level of maintenance); the supply of new rental units subsequent to the imposition of controls; mobility effects; and the distributional impact of controls in terms of who benefits and who bears the costs of the system.

2.0 RENTS

The nominal objective of any form of rent regulation is to hold rents for some part of the rental housing market below what they would be in the absence of controls. Controls may (or may be designed to) do this in both the short run -- perhaps several years -- and the long run -- perhaps several decades -- or they may be designed to prevent rents from rising very rapidly in the short run, but not to alter their long run level. Theory suggests that where part of the rental stock is exempt from controls (about 20% in the case of Ontario in 1982), two distinct markets will develop. Theory indicates that not only will rents in the uncontrolled sector (R_u) exceed those in the controlled sector (R_c), for units of comparable quality, but also that R_u will exceed the market clearing or equilibrium level of rents (R_e) that would occur in the absence of controls. Hence $R_u > R_e > R_c$. See Fallis & Smith (1984b) and (1985a) and Marks (1984b).

Theory alone, however, cannot predict the size of the differences between R_u, R_e and R_c because of the influence of variables largely outside the rent control system, notably changes in the basic demand and supply conditions. (Demand, for example, is influenced by net household formation, changes in real income per capita and the prices of substitutes, notably house ownership. Supply is influenced by interest rates, operating costs, how rent regulation treats new units, and building costs.) As we shall see, it is not an easy task to determine the effects of rent regulation on the level and rate of change of rents. These difficulties include the fact that it was not until 1982 some six years after controls were imposed in Ontario, did CMHC alter its method of collecting information on rents to be able to distinguish rents for controlled and uncontrolled units.

We begin our discussion of rents by reviewing the publicly-available data on the average rate of increase in rents in Ontario. Then we move to more sophisticated efforts to measure the rate of increase in rents in the controlled and uncontrolled sectors taking into account differences in the quality of rental units.

2.1 Rent Increases in Ontario

2.1.1 Statutory Guideline: Table 6-1 indicates that the statutory guideline rent increase under Ontario's system of rent regulation was 8% per annum from the end of July 1975 to the end of October 1977. Thereafter it was 6% per annum. In April 1985 the Minister of Consumer and Commercial Relations announced that the PC government proposed to reduce the statutory rate of increase to 4% in light of the decline in the rate of inflation.

The guideline rate is important in that the vast majority of rental units in Ontario have not gone to rent review to obtain a higher rate of increase on the cost pass-through basis. Table 6-1 indicates that only from 18,370 to 131,455 units per year were granted an increase above the statutory rate. To put these numbers in perspective it is necessary to appreciate that as of mid-1981 some 839,000 rental units were subject to rent control in Ontario (Pringle, 1985, Figure 4.1). Therefore, even in the peak year of 1976, less than 16% of rental units in the controlled stock obtained a legal rent increase above the statutory rate. That does not mean, however, that all other controlled units had rent increases of the statutory rate or less. First, some landlords ignored rent controls and with or without the agreement of their tenants, increased rents above the statutory rate without justifying the increase before the regulatory body. This process is made easier by the absence of a rent registry (see Thom, 1984, Ch. 17), and the fact that since 1979 it has not been a criminal offence to raise rents above the legal level except where the legal rent has been established by an order of the Residential Tenancy Commission. Second, we estimate, based on data in MOMAH annual tenant surveys that about an average of 23% of the controlled units did not experience a rent increase in any particular year from 1977/78 to 1980/81. As we document in section 9.7 of this chapter, it is mainly non-movers that received this benefit.

We note that the statutory guideline rate of increase was below the rate of increase in the Toronto CPI in seven of the ten years between 1975 and 1984. In 1980, 1981 and 1982 the statutory rate was between 4.2 and 6.5 percentage points below the increase in the CPI -- see Table 6-1.

2.1.2 Increases Granted Under Rent Review: While only a small minority of rental units applied for and were granted increases above the statutory rate, landlords who "played the game" were rewarded with increases at least three percentage points above the statutory rate. In some years, e.g., 1981 and 1982, the increase granted was more than double the statutory rate -- see Table 6-1.

Between 1976 and 1983, the average rate of increase granted under rent review exceeded the increase in the Toronto CPI. For example, in 1976 and 1977 the difference was about five percentage points.

Table 6-2 indicates that units in buildings containing over six rental units were substantially "over-represented" in terms of successful applications for rent increases above the statutory rate. While 66% of all rental units in Ontario are in "larger" buildings (those with more than six units), such buildings usually accounted for 85% of all units gaining an increase above the statutory rate -- see Table 6-2.

While "larger" buildings went to rent review more frequently, the average rate of increase they received appears to have been influenced by whether or not they had an elevator in them -- but this appurtenance may simply be a proxy for even larger buildings, for example, more than twenty units. In any event, the data in Table 6-2 indicates that larger buildings with an elevator consistently received about one percentage point less than the average for all buildings.

On the other hand, although small buildings (under six units) were under-represented in rent review proceedings, they regularly obtained higher-than-average increases. They typically "outperformed the average" by three percentage points. Larger buildings without an elevator also were awarded increases about one percentage point above the average in all years but one -- see Table 6-2.

2.1.3 Rent Increases in the Toronto Area: Table 6-3 reports percentage increases in rent for one- and two-bedroom units for various jurisdictions within the Toronto area based on CMHC data. Unfortunately, as noted at the bottom of the table, the data are based on three different survey methodologies. The data for the October 1974 to October 1977 surveys is not comparable to that for subsequent surveys. The earlier data, being based on asking rents for vacant units (in larger buildings) reflects rents at the margin, i.e., the measure that is most sensitive to market conditions. In periods of excess demand (low vacancy rates), the measured rate of increase will overstate the rate of increase actually experienced by most tenants.

Taking the rate of increase for one-bedroom units in the City of Toronto (which has consistently had low vacancy rates -- see below), for the twelve-month rate of increase based on the October survey, we note that between 1976 and 1984 rent increases were greater than the increase in the Toronto CPI in three of the nine years. For two-bedroom units, annual rent increaess were more than incrases in the CPI in only two years sduring the same period.

Within the Toronto CMA rent increases for one-bedroom units were greater than the increase in the CPI in only two years (1983 and 1984) of the nine between 1976 and 1984. For two-bedroom units the comparable figure was three years.

Table 6-1 indicates that only in 1983 and 1984 did the increase in the rent component of the Toronto CPI exceed the annual increase in the total Toronto CPI between 1976 and 1984. If we compare increases of the Toronto rent index (Table 6-1) to those for one-bedroom units in the Toronto CMA (Table 6-3), we find that in five of the nine years bewteen 1976 and 1984 the increase in the latter was greater than in the former. The rent index is based on rental units of identical quality whereas the CMHC measure ignores quality differences. Over several years this could produce a significant different in the two measures.

2.1.4 Increases in Controlled and Uncontrolled Units: As we noted above, it is only since 1982 that CMHC has collected data on rent increases in the two sectors separately -- even though the uncontrolled sector in 1981 represented 23% of all rental units (albeit 60% of which take the form of social housing). The data for the Toronto CMA for 1982 - 1984 are reported in Table 6-3. In the case of one-bedroom units the rate of increase in the controlled sector was less than that in the uncontrolled sector in five of the six measures we have. For two-bedroom units, it was less in four of the six measures. The greatest differences occurred in 1982, a year in which the Toronto CPI increased by 11.3% and the vacancy rate in the Toronto CMA was 0.4% in April and 0.7% in October. It appears that rent controls reduced the rate of increase by between three and seven percentage points.

2.1.5 Rent Increases and the Growing Cost of Ownership Housing: Table 6-4 provides indices for the rent component of the CPI for Toronto, Ottawa and Canada and for ownership accommodation for Toronto. It indicates that between 1975 and 1984 the rent component of the Consumer Price Index in Ottawa and Toronto rose virtually the same amount -- by some 65%. This was only slightly

Table 6 - 1

Rent Increases and Price Indices, 1973 - 1984

Year	ONTARIO Rent Review			Canada			Toronto				Pers. Income per capita in Ontario % change
	% increase granted	number of units	Stat. Guideline % change	CPI % change	Rent Index % change	Housing Price Index % change	CPI % change	Rent Index % change	Housing Price Index % change	New House Price Index % change	
1973	nap	nap		7.7	1.4	6.5	6.7	1.6	7.3		13.1
1974	nap	nap		10.9	2.7	8.7	10.6	2.6	8.4	24.7	15.9
1975	nap	nap	8%**	10.8	5.4	10.0	10.7	6.0	9.7	13.1	12.9
1976	12.6	131,455	8	7.5	7.0	11.1	7.3	6.1	10.6	2.1	12.0
1977	12.5	39,219	8	8.0	6.3	9.4	7.8	5.6	8.9	4.5	9.2
1978	9.7	40,949	6 ***	8.8	5.3	7.5	8.5	4.9	7.5	-1.5	9.9
1979	11.3	18,370	6	9.2	4.4	7.0	9.2	4.4	6.9	0.2	10.7
1980	11.6*	42,377	6	10.2	4.8	8.2	10.2	4.4	7.9	0.2	11.4
1981	14.7*	82,651	6	12.5	6.4	12.4	12.5	5.3	12.2	7.3	16.9
1982	14.2*	127,812	6	10.8	9.0	12.5	11.3	7.4	12.9	17.6	9.2
1983	10.6*	106,472	6	5.8	7.5	6.8	6.0	7.5	6.1	-7.1	n/a
1984	10.0	53,786	6	4.4	5.0	3.7	4.8	5.6	4.0	1.1	n/a

* 1980 = 1980/81 and so on

** effective July 29, 1975, all decisions affecting 1975 were made in 1976 retroactive to July 1975.

*** effective October 27, 1978.

nap = not applicable
na = not available

Sources: Office of Rent Review and Residential Tenancy Commission, Annual Reports; Statistics Canada, prices and price indices.

Table 6 - 2

Increases Granted Under Rent Review In Ontario by Size of Building, 1976-1983/84

Period	Buildings With More Than 6 Units			Number of units receiving an increase	% Increase Granted			
	NE >6 units	E >6 units	Total % >6 units		NE >6 units	E >6 units	≤ 6 Units	All Units
1984/85			vs 66%	53,786				10.0
1983/84	19,542	79,353		106,472	12.2	9.9	13.8	10.6
	18.4%	74.5%	92.9		+1.6*	-0.7*	+3.2*	
1982/83	23,068	87,025		127,739	16.2	13.2	16.5	14.2
	18.1%	68.1%	86.2		+2.0	-1.0	+2.3	
1981/82	16,458	56,269		82,650	15.8	13.8	18.1	14.7
	19.9%	68.1%	88.1		+1.1	-0.9	+3.4	
1980/81	7,975	28,184		42,377	11.8	10.7	14.7	11.5
	18.8%	66.5%	85.3		+0.3	-0.8	+3.2	
1979/80	2,983	13,580		19,469	11.7	9.7	14.4	10.7
(7 mos)	15.3%	69.8%	85.1		+1.0	-1.0	+3.7	
1979	3,180	11,348		18,370	10.4	10.0	15.4	11.2
	17.3%	61.8%	79.1		-0.8	-1.2	+4.2	
1978	5,003	30,434		40,949	9.9	9.0	13.4	9.7
	12.2%	74.3%	86.5		+0.2	-0.7	+3.7	
1977	4,481	27,892		39,219	12.9	11.7	15.5	12.5
	11.4%	71.1%	82.5		+0.4	-0.8	+3.0	
1976	16,117	96,497		131,455	n/a	n/a	n/a	12.6
	12.2%	73.4%	85.6					

NE = non-elevator building
E = elevator building

* = amount above or below the average for all units

Source: Compiled or derived from the Annual Reports of the Residential Tenancies Commission and Ontario Rent Review Office (Toronto, various years).

Table 6 - 3

Rent Increases in the Toronto Area, 1974 - 1984

	% change over previous 12 months						% change over previous 12 months			
	City of Toronto		Metro Toronto		Toronto CMA		Toronto CMA			
							Under Rent Control		Not Controlled	
Date	1 bed	2 bed	1 bed	2 bed	1 bed	2 bed	1 bed	2 bed	1 bed	2 bed
1984 Oct	7.1	6.2	6.0	4.9	6.2	5.5	6.2	5.4	6.3	5.7
April	7.7	5.0	5.9	4.7	5.8	4.9	5.9	5.2	5.2	3.9
1983 Oct	7.2	5.5	7.0	6.3	6.6	6.2	6.5	6.3	7.3	5.8
April	7.3	7.6	8.9	9.4	8.6	8.9	8.5	8.8	9.7	9.4
1982 Oct	10.5	16.3	10.9	12.1	10.8	11.8	10.5	11.0	13.4	16.8
April	9.2	17.0	10.0	11.8	10.1	11.7	9.5	10.8	15.8	17.8
1981 Oct	8.6	7.6	9.3	9.0	9.7	9.5	[data not available]			
April	8.2	4.5	7.0	6.2	7.1	6.8				
1980 Oct	6.0	5.1	5.2	5.9	5.5	6.6				
April	7.4	5.9	7.4	7.9	7.2	7.7				
1979 Oct	9.0	8.7	8.8	7.5	8.5	7.4				
April	na	na	na	na	na	na				
1978 Oct	1.1	2.8	na	na	2.4	2.1				
April	na	na	na	na	na	na				
1977 Oct	11.3	5.5	na	na	2.9	0.0				
April	10.5	-0.6			7.5	6.5				
1976 Oct	-5.6	-6.6			4.8	6.6				
April	4.4	0.3			5.1	-2.1				
1975 Oct	18.9	17.8			8.5	-2.5				
April	20.7	29.8			15.0	26.7				
1974 Oct	17.1	4.1			23.1	36.2				
April	na	na			na	na				

na = Data not available

Oct. 1974 - Oct. 1977: sample of asking rents on vacant units in buildings of 6+ units, privately initiated.
Oct. 1978 - Oct. 1981: sample of units visited for vacancy survey; 6+ units, privately initiated.
Apr. 1982 - Oct. 1984: subsample of rent survey where a unit has been included in at least three consecutive surveys.

Source: CMHC, Rental Apartment Vacancy Survey (Toronto: various years).

Table 6 - 4

Rent and Housing Indices, 1971 - 1982

YEAR	Toronto: Owned accommodation	Toronto: Rent component of CPI	Ottawa: Rent component of CPI	Canada: Rent component of CPI
1984	291.0	184.2	186.5	190.6
1983	283.5	174.4	176.1	181.4
1982	269.7	162.2	162.6	168.7
1981	237.0	151.1	152.7	154.8
1980	209.2	143.5	146.7	145.5
1979	196.7	137.5	141.2	138.9
1978	188.2	131.7	134.5	133.0
1977	174.2	125.5	127.2	126.3
1976	158.1	118.9	118.6	118.9
1975	140.0	112.1	112.7	111.1
1974	127.7	105.7	108.2	105.4
1973	117.8	103.0	104.7	102.6
1972	106.9	101.4	102.0	101.2
1971	100.0	100.0	100.0	100.0

Sources: Pringle (1985, Tables 3.4 and 3.5), and Statistics Canada.

below the increase in the rent component of the Canada-wide CPI (71.6%). What is more interesting is to note that the price index for owned accommodation in Toronto increased by 107.8% between 1975 and 1984. In other words, the price of ownership housing rose relative to that of rental housing, about 77% of which was subject to controls during this period.

2.2 Fallis and Smith (1985a)

Fallis and Smith use the hedonic price approach to estimate a quality-adjusted price index for rental units. The approach assumes a housing unit can be described by a vector of characteristics such as size, number of bathrooms, location, age, and the presence/absence of certain amenities. It is assumed that the market establishes the price for a rental unit as a bundle of these housing characteristics. One may then derive the implicit price of each of these characteristics. The object of the analysis is to determine what fraction of the observed difference in the level of rents in the controlled and uncontrolled markets is attributable to

- differerences in the quality of the units as measured by the implicit price of the specific characteristics of a unit, and
- differences that are attributable to the unit being rent controlled or not.

In constructing the price index to compare implicit prices of characteristics in the two sectors the analyst may use either the housing characteristics of the controlled sector or those of the uncontrolled sector. Different results will be obtained. The analyst must make other choices (assumptions) as well, such as

- the functional form of the equation to determine the price of a bundle of characteristics
- the nature of the relationship between the price functions in the two sectors -- one can assume the two functions are the same and the coef-

ficients for each characteristic (parameters) are the same except for the constant term, or that the functional form is the same, but the parameters are different. Fallis and Smith used both approaches.

The data used to estimate the equations were obtained from a random sample of 175 privately-owned buildings subject to rent control and 140 privately-owned buildings not subject to controls. In both cases the buildings contained six or more units, and were located in the Toronto CMA. A mail survey, sent to eight randomly drawn units in each building, was done in November 1982. A response rate of 45% was achieved resulting in data on 637 units in the uncontrolled sector and 500 in the controlled sector.

For each unit, data on 42 housing characteristics were collected, but since the practical effects of using a much smaller number of variables is small, ten characteristics were included in the final regressions which contained 398 units in the controlled and 305 units in the uncontrolled rental market. The characteristics were as follows:

- number of extra rooms (total rooms -- bedrooms)
- number of bedrooms
- number of bathrooms
- floor level of the apartment
- air conditioning included (Yes = 1, No = 0)
- dishwasher included (Yes = 1, No = 0)
- parking included (Yes = 1, No = 0)
- year of construction
- distance from city centre (measured in kilometres from City Hall)
- neighbourhood quality (1 = high/good quality; 0 otherwise)

(We note that Fallis and Smith make no effort to include the level of maintenance as an explanatory variable. Yet in their other work they argue that maintenance will be reduced in the controlled sector because of rent controls.)

The sample data indicated that the average monthly rent in the controlled sector was $358 versus $520 in the uncontrolled sector. However, on average, the latter were of higher quality: newer; more bedrooms, bathrooms, extra rooms;

Table 6-5

Summary of Results of Fallis and Smith on Differences Between R_u and R_c, as at November 1982

	Ratio of uncontrolled to controlled rent (R_u/R_c)	% of difference in rent level due to controls
• POOLED DATA (assumes hedonic price function is same for both sectors)		
• Linear		
• controlled sector weights	1.29	60%
• uncontrolled sector weights	1.25	52%
• Semi-log (apparently uncontrolled sector weights)	1.24	50%
• SEPARATE EQUATIONS		
• Linear		
• controlled sector weights	1.15	31%
• uncontrolled sector weights	1.24	50%
• Semi-log		
• controlled sector weights	1.14	29%
• uncontrolled sector weights	1.27	56%

Source: tabulated from Fallis and Smith (1985a).

had extra facilities; were in higher quality neighbourhoods. But, they were further from the city's centre.

The results of Fallis and Smith's various equations are summarized in Table 6-5. They found that when quality differences are taken into account the absolute difference in rent between the uncontrolled and controlled sectors was $106 per month. Therefore, depending on the weights chosen, the apparent effect of rent controls was to make the ratio R_u/R_c equal to 1.25 or 1.29 when quality differences are taken into account. As Table 6-5 indicates, the ratio varies with the functional form used and which sector weights were applied. Fallis and Smith (1985a) conclude as follows:

> Depending on the characteristics of the housing being priced, rents were from 14 to 27 per cent higher in the uncontrolled than in the controlled sector; with the average of the eight price indices being 22.75 per cent. Consequently, 47 per cent (22.75 ÷ 48) of the difference in nominal rents is explained by the effect of rent control on prices.

They note that based on their earlier work (1984a), R_e would have been about midway between R_u and R_c.

Steele and Miron (1984, p. 44) cite the conclusions of Jazairi (1983) who applied a hedonic price model to the same data set as that analyzed by Fallis and Smith (1985a, 1985b). Jazairi (1983, p. 26) found that after quality differences are taken into account, the difference between average rents in the controlled and uncontrolled sectors (as of November 1982 in Toronto) is between 9 and 14 percentage points. And Jazairi suggests that the lower estimate is the better one. Steele and Miron (1984, p. 44) suggest it may even be less than 9 percentage points for "it is possible that much of the estimated differential is attributable to newness rather than to exemption from rent review". This point is based on "the strong correlaton between newness and exemption from rent review in Jazairi's data set" (Steele and Miron, 1984, n. 35, p. 97). Moreover, Steele and Miron (1984, p. 45) note that Jazairi did not include as an independent (explanatory) variable the length of tenure of tenants despite the well-established finding that long-term tenants, on average, enjoy a discount on their rent. Finally, following Fallis and Smith (1984b), they note that in the absence of controls the market clearing level of rents will fall between the observed rent in the controlled and uncontrolled sectors. In summary, therefore, they conclude that the effects of rent control are rather small -- although risk averse renters do benefit to the extent that controls reduce the risk of very large increases in rent that might be suffered by a small fraction of all renters.

2.3 MOMAH (1983) - Rental Market Survey

The Ministry of Municipal Affairs and Housing has collected data on rents based on a sample survey (n = 200 to 300 per city) in the controlled sector and the uncontrolled sectors for several Ontario cities on an annual basis for several years. While their data do not account for differences in quality across units within that sector they do serve to indicate how much rents have increased relative to the Consumer Price Index or incomes since controls have been in place. The data in Table 6-6 indicate that for non-movers (50% to 70% of all renters in the survey), median annual increases between 1977/78 and 1982/83 were below the CPI and the increase in average weekly wages except for 1977/78.

Several points should be noted about these data. First, the rent increases are for non-movers, those who have occupied their units for at least one year. Other MOMAH Rental Market Survey data cited in Stanbury (1985a, p. 3-35) indicate that the fraction of tenants in the Toronto CMA who have moved in the previous year decreased from 41% in 1976/77 to 29% in 1980/81 and 1982/83. The comparable figures for London were 55% in 1976/77, 45% in 1980/81 and 41% in

Table 6-6

Increases in Rent for "Non-Movers"

Relative to CPI and Wages

	METRO TORONTO			increase in average weekly wages (Ontario)	LONDON	
Year***	median rent increase	average rent increase	CPI (all items)		median rent increase	average rent increase
1978/77	5.9%	6.8%	8.5%	5.8%	5.7%	6.0%
1979/78	5.9	6.3	9.3	8.2	5.3	4.5
1980/79	6.0	6.9	10.1	9.1	5.6	5.6
1981/80	6.1	7.9	12.5	11.7	5.7	6.4
1983/82*	6.2	8.2	11.3	9.9**	6.0	7.8

* preliminary period ending January 1983

** based on 10 months

*** survey in October each year

Source: Rental Market Survey as found in MOMAH (1983, p. 40)

1982/83. Therefore, the fraction of non-movers increased during the period rent controls have been in place. Although controls are applied to the unit rather than the tenant, the absence of a rent registry, and the reasons given for moving (see Stanbury, 1985a, p. 3-38) suggest that the rate of increase experienced by movers is higher than that for non-movers. (Also some of the moves will be from controlled to the uncontrolled sector.) While Table 6-6 applies to units of comparable quality (in fact, exactly the same unit is being measured 12 months apart), we cannot determine the gap between rents in the controlled and uncontrolled sectors for units of comparable quality. While units in the uncontrolled sector are, by definition, free of controls, the vacancy rate for such units is higher than that prevailing in the controlled sector - see section 7.4 below. Hence this may tend to hold down rent levels, ceteris paribus.

Third, we note from Table 6-6 that the median annual rent increase for Toronto and London has been very close to the statutory increase of 6% under the control regime. It is obvious that controls have reduced the year-to-year variation in median rent increases below that for the CPI, and average weekly wages.

Fourth, in most years, the average increase in rents in Toronto and London exceeded the median increase. This indicates the distribution of rent increases is positively skewed, meaning that a noticeable fraction of even non-moving tenants experienced rent increases well above the average.

Fifth, the data in Table 6-6 do not distinguish between rent increases in the controlled and uncontrolled sectors. MOMAH (1983, p. 42) cites CMHC data for rent increases between October 1981 and October 1982 indicating that rents for 2-bedroom apartments were rising at a much faster rate than those subject to rent control. See Table 6-7.

Table 6-7
Average Rent Increases for 2-bedroom Units in Buildings of 6 or More Units, October 1982 versus October 1981

Census Metropolitan Area	Oct. 1982 vs. Oct. 1981		Oct. 1983 vs. Oct. 1982			Oct. 1984 vs. Oct. 1983		
	Controlled	Uncontrolled	All Units	Controlled	Uncontrolled	All Units	Controlled	Uncontrol.
Hamilton	8.3%	10.6%	n/a	n/a	n/a	6.1%	7.7%	3.5%
Kitchener	9.8	12.1	6.3%	6.6%	5.1%	6.6	6.7	6.5
London	8.8	12.7	4.7	4.9	4.3	5.0	5.7	3.8
Oshawa	11.7	18.9	6.4	n/a	n/a	6.9	7.7	4.8
Ottawa	8.2	17.8	8.3	8.2	8.8	4.9	4.0	7.7
St. Catherines/ Niagara	12.1	17.0	4.0	4.0	3.6	6.9	6.4	9.2
Sudbury	7.0	18.4	7.4	7.2	12.9	4.0	4.1	n/a
Thunder Bay	7.3	8.1	8.3	7.0	10.0	7.3	6.0	8.8
Toronto	11.0	16.8	6.2	6.3	5.8	5.5	5.4	5.7
Windsor	3.9	6.1	7.4	7.0	7.7	13.2	7.0	17.7

n/a = not available

Sources: MOMAH (1983, p. 42) and unpublished data provided by MOMAH from CMHC Special Surveys, October 1983 and October 1984.

2.4 Fallis and Smith (1985b)

From the same survey of rent controlled and uncontrolled units described in the Toronto CMA in November 1982 above, Fallis and Smith provide evidence of the distribution of the benefits of lower rents in the controlled sector. However, following their earlier work (AER, 1984; CMHC, 1984), Fallis and Smith emphasize that a system of rent control with exemptions makes some tenants better off than they would be in the absence of controls and others worse off. In other words, $R_u > R_e > R_c$. [This point is also made by Marks (1984b) and even earlier by Econanalyses Consulting in MOMAH (1982). Perhaps the first author to make this point was Lindbeck (1967).]

They point out that a rigorous analysis of the distributional effects of rent controls in terms of changes in the level of rent would require measurement of changes in consumer's surplus (the area below the demand curve and above the price). [More generally, see Olsen, 1972.] But this would require knowledge we don't possess: households' utility functions and precise estimates of the price changes under controls. Instead, Fallis and Smith worked on the assumption that tenant benefits and losses are proportional to the value of their housing consumption under controls. They indicate that the pattern of tenant benefits by income class depends on four principal factors:

- the effect of controls on R_u and R_e;
- the process of rationing controlled units, hence the distribution of income of tenants in controlled and uncontrolled sectors;
- the housing consumption of tenants and how it changes with income; and
- the relative size of the controlled and uncontrolled sectors.

Fallis and Smith found that the average monthly rent in the uncontrolled sector was $530 while that in the controlled sector was $358. The average rent-to-income ratio was .196 in the controlled sector and .238 in the uncontrolled sector, although the average household income of tenants in the uncontrolled sector was $26,716 while in the controlled sector it was $21,936.

Apparently based on their CMHC (1984a) paper -- see below -- Fallis and Smith indicate that tenants in the controlled sector benefit by rent reductions 11% below what they would have been in the absence of controls. Conversely, tenants in the uncontrolled sector lost because their rent was 9.2% above what it would have been in the absence of controls. [Note, these numbers don't correspond exactly with the figures in the CMHC paper which states that R_u/R_e = 1.06 and $R_e/R_c - 1 = 11\%$.] Therefore, the average tenant in the controlled sector in the Toronto CMA as of November 1982 was benefitting to the extent of $531 per year. Tenants in the uncontrolled sector -- one-quarter of the number in the controlled sector -- were losing an average of $536 per year.

2.5 MOMAH (1982)

The Ministry of Municipal Affairs and Housing commissioned Econalysis Consulting Services to construct a simulation model of several local private housing markets in Ontario from 1976 to 1981 and from 1981 to 1986. Three sub-sectors were considered: home ownership, controlled market rentals and uncontrolled market rentals. On the supply side, the model incorporated such variables as profitability, previous starts, demolitions and transfers, and various costs. The demand side incorporated such variables as household income, the inflation rate, mortgage rates, household formaton by type and changes in the labour force.

The results of the simulation, which the authors find easy to explain in terms of changes in supply, demand and rent regulation, indicate that in real terms rents in the Toronto CMA decreased from 79 in 1976 (1971 = 100) to 67 in 1981 in the controlled sector. Rents in the uncontrolled sector increased from 80 in 1976 to 87 in 1981. [These data are taken from a diagram, p. 24; no table was provided.] By comparison, the real price of homeownership decreased slightly from 132 in 1976 (1971 = 100) to 130 in 1980 and then increased back to 133 in 1981.

These data suggest that the ratio of real R_u to real R_c in 1981 for the Toronto CMA was 87/66 = 1.38. It will be recalled that Fallis and Smith (1985a) found that R_u/R_c as of November 1982 was 1.48 before any correction for quality differences. Of course, the MOMAH simulation ignores differences in quality.

2.6 Fallis and Smith (1984a)

Fallis and Smith (1984a, p. 40) argue that the "theoretically most rigourous method of determining rents in the absence of controls would be to empirically estimate a model of rent determination in the pre-rent controls period and, assuming no structural changes in the market, use the model to forecast what equilibrium rents would have been in the control period". They refer to Arnott (1981), Smith (1974) and Kalymon (1981) for Canadian cities and to Rosen and Smith (1983) for U.S. cities.

The type of model the above authors suggest would be appropriate is as follows:

$$R = f(OC, D, V_n - V)$$

where

R = rate of change in the nominal level of rents
OC = rate of change in operating costs of rental buildings
D = the rate of depreciation or deterioration in rental buildings
$V_n - V$ = the difference between the natural vacancy (V_n) and the actual vacancy rate (V).

However, Fallis and Smith say this equation would be inappropriate for, inter alia, the following reasons. First, the difference between V_n and V holds only over a normal range of vacancies. With controls, V may well fall below 1% in some markets and hence the difference between V_n and V may not reflect the full extent of the excess demand because of the existence of an unobserved queue for housing services. Second, the equation specified above to estimate what the rate of increase in rent would have been in the absence of controls implies that both the demand for and supply of rental housing are not affected by the existence of rent controls. In general, for example, controls will tend to restrict the supply of new rental units. Third, Fallis and Smith suggest that it is likely that the natural vacancy rate changed, even without controls, between the early 1970s and the early 1980s -- see Smith and Rosen (1983).

Fourth, the model is specified in terms of the rate of increase in rents, not their level. Therefore, one needs to have an accurate estimate of the level of rents just prior to the imposition of controls and to assume that the rate of deterioration of the quality of housing services will be the same after controls were imposed as in the period prior to their imposition. Since there is reason to believe, theoretically and empirically, that the rate of deterioration is likely to increase under controls the proposed equation would overestimate the rate of increase in rents for the post-controls housing characteristics.

Fallis and Smith (1984a), therefore, used a less formal methodology -- an adjusted real rent approach under which it is "assumed essentially that in the absence of rent controls the rate of increase in the real rent for a given quality of housing services would have been the same as in the recent pre-control period ...". The increase is calculated in two stages. First, the historical relationship between the rate of increase in rents and inflation is ascertained in order to predict the rent increase that would have occurred had the rental market been in equilibrium when controls were imposed. Second, the rental market when controls were implemented is examined and an adjustment is made to reflect the increase in real rents that would have been necessary to restore equilibrium. (This argument may be questionable. With a two market system, it may be more appropriate to talk about what the vacancy rate would be in the absence of controls if we're going to talk about what the real rent increase would have been in the absence of controls. On this basis if rents in the controlled sector were allowed to float up the vacancy rate may be much higher and the uncontrolled scenario could be quite different.)

Slack and Amborski (1984, pp. 20-25) discuss the interesting case where, due to imperfect competition, the market rent is above the long-run perfectly competitive level and rent control reduces rents in the controlled sector perhaps to the competitive level or below it. They note that the main different in the imperfectly competitive case over the perfectly competitive one in partial equilibrium is that in the latter there is excess demand in the regulated sector and consequently higher rents in the unregulated market (recall Fallis and Smith, 1984b). If rent regulation pushed the rents of existing units down to the competitive level landlords suffer a loss, but continue to earn a normal return. If new buildings are exempt, neither landlords nor tenants are affected in this case. See Slack and Amborski (1984, p. 25).

Then the predicted increase in rent levels in the absence of controls is compared to the actual increase in the uncontrolled market when rent regulation is in place. The object is to determine the relationship between uncontrolled rents under regulation (R_u) and the equilibrium level of rents in the absence of controls (R_e).

R_u was calculated by Fallis and Smith in three steps. First, the actual increase in rent for controlled units (R_c) was calculated. Second, R_c was adjusted for quality changes associated with controls and the historical relationship between rent increases and inflation. Third, "the difference between the 1982 uncontrolled hedonic price of 1982 rent controlled housing services and the actual 1982 controlled rent for these services ... is added to the actual increase in the rent on rent controlled units to determine the increase in the index of uncontrolled rents under rent review".

Fallis and Smith (1984a, p. 45) found that between 1961 and 1975 in Canada the CPI rose by 86.7% while the rent component of the CPI rose by only 34.8%. For the U.S. between 1960 and 1980 the comparable figures were 179% and 108% respectively. They discuss several factors that may have accounted for the decline in real rents: real economic deterioration in rental units (unmeasured depreciation); the failure of the rent component to include fuel and utility costs paid by tenants; the shift in the relative user costs of homeownership and renting in favour of homeownership.

Fallis and Smith (1984a, p. 49) assumed that the "increase in the equilibrium rent in the absence of controls would have been approximately 85.0 per cent of the increase in the overall CPI, with virtually all of the difference ... being accounted for by the unmeasured normal deterioration in rental housing services".

The vacancy rate for the Toronto CMA declined from 3.6% in 1971 to 1.1% in 1974, then rose to 1.8% in 1975, well below the natural vacancy rate. Therefore, Fallis and Smith (1984a, p. 50) conclude that "a rent increase in excess of that normally associated with the rate of inflation could be expected to have occurred in the absence of rent controls". They offer two estimates of the additional increase in real rents necessary to restore equilibrium: 3.58% based on Smith (1974) and 1.59% based on Arnott (1981). Using the former and noting that the CPI increased by 98.8% between July 1975 and November 1982, the increase in rent that could be expected to have occurred in the absence of controls (R_e)between July 1985 and November 1982 was estimated to be

$$(1.0358)\ [1 + (98.8)(0.85)] - 1 = 90.6\%.$$

To estimate the increase in the index of uncontrolled rents (R_u) it is necessary to determine the increase on the average rent on controlled units. Fallis and Smith (1984a, p. 52) compute the latter by summing the following:

(i) the increase that would occur if all rents were increased at the statutory annual maximum rate;

(ii) increases above the statutory rate allowed by the regulatory authority; and

(iii) illegal rent increases.

The figure for (i) between July 1975 and November 1982 was 60%, while that for (ii) was estimated to be 5.48% for the Toronto CMA, which was rounded off to 6%. No adjustment was made for illegal rent increases. Therefore, the estimated increase in the rent of rent controlled units (R_c) was

$$(1.06)(1.60) - 1 = 69.6\%.$$

Fallis and Smith did not make any adjustment for quality deterioration.

In order to estimate the actual increase in the index of uncontrolled rents under controls (R_u), Fallis and Smith adjusted the estimated increase in controlled rents for the difference between uncontrolled and controlled rents for constant quality units in November 1982. Using the ratio of R_u/R_c for constant quality units of 1.24 from Fallis and Smith (1985a), they estimate that the average rent of uncontrolled units increased by

$$(1.696)(1.24) - 1 = 110.3\%.$$

Therefore, for the period July 1975 to November 1982 Fallis and Smith estimate the following increases for the Toronto CMA for rental units of equivalent quality:

- R_u +110.3%
- R_e + 90.6%
- R_c + 69.6%

Therefore, the level of R_u is approximately 10.3% higher than R_e [(210.3 ÷ 190.6) - 1], but "if the biases remaining in the calculation were removed, the calculated differential would likely be increased" (Fallis and Smith 1984a, p.

57). The data also indicate that the level of R_c is about 11% lower than R_e [(169.6 ÷ 190.6) - 1]. That is, after 88 months of controls, the average rent in the controlled sector of the Toronto CMA (adjusted for quality differences) was 11% lower than it would have been in the absence of controls.

[Comment: this does not seem to be a large difference after more than seven years of controls]

Note, R_u as measured by Fallis and Smith overstates the average rent received by the landlord for his building as a whole /because of the higher vacancy rate in the uncontrolled sector than in the controlled sector their survey in November 1982 went only to units which were occupied. Given the less than 1% vacancy rate in the controlled sector versus almost 6.3% vacancy rate in the uncontrolled sector (April 1983 -- see Table 6-25), the degree of overstatement of R_u from the landlord's point of view (rather than the tenant) is substantial.

More generally, we note that this paper uses vacancy rates a the driving force for changes in rents. It seems to us that what is important is the factor which is driving rent changes for marginal units -- presumably marginal units are a new unit. In a two market system where uncontrolled units are new units it may be reasonable to argue that both supply and price changes at the margin are driven by vacancy rates in the uncontrolled sector only. Using vacancy rates for the market as a whole may be misleading. From this approach the rental market may be in equilibrium since the relevant vacancy rate is close to the natural vacancy rate.

3.0 THE PRICE OF CONTROLLED BUILDINGS

3.1 Smith and Tomlinson (1981)

Smith and Tomlinson (1981, p. 95) argue that the "dominant feature of rent control in Ontario is the cost-pass-through process" which has the effect of fixing in nominal terms the pre-control level of cash flow for controlled buildings. Therefore, with inflation real net cash flows will decline. They estimate that real rents for 1-bedroom apartments declined by 11% to 12% between July 1975 and the end of 1980 (p. 112, fn 7).

Smith and Tomlinson argue that the value of income producing property is based upon its expected future income stream and that controls, by freezing nominal net rents at their 1975 level, will cause a downward revision in expected net rentals. Hence the capital values will fall. This did occur in the case of units in buildings of 6 or more units in the City of Toronto. The average price, in nominal terms, decreased from $18,903 in 1975 (pre-controls) to $17,617 in 1976 and then remained relatively constant, averaging $17,273 throughout the period 1976 - 1980. Smith and Tomlinson (1981, p. 97) conclude that "this pattern in nominal capital values is consistent with an initial downward shift in the expected future net rental stream upon the introduction of controls, and with the expectation of a relatively constant future net rent thereafter as a result of the cost-pass-through process".

In real terms, the capital value of apartment units "declined steadily" from 1975 to 1980, a total of 39%. "In 1980 the capital value of rental apartments was 29% and 30% lower than 1975 relative to the Multiple Listing Service (MLS) value of all residential dwellings and condominium apartments respectively in Metropolitan Toronto" (p. 97).

Several points should be noted about Smith and Tomlinson's summary of their findings. First, nominal capital values can change for a variety of reasons other than the effect of rent controls on future net rental income. These include changes in the discount rate applied by potential investors in rental properties -- which may in turn be influenced by controls, movements in interest rates and other factors. Ceteris paribus, the imposition of controls may reduce the discount rate for rental buildings in the controlled sector (and increase it in the uncontrolled sector) because of the reduction in vacancy rates that usually occurs after controls have been in place for a while. Interest rates in Canada changed little between 1975 and 1978 (the rate for Government of Canada bonds 10+ years moved from 9.03% to 9.27%), then they increased noticeably in the next two years (10.21% in 1979; 12.48% in 1980).

Second, the pattern of changes in the nominal average price of rental units was less regular than Smith and Tomlinson suggest. Consider the following rates of change between 1974 and 1980:

period	change in nominal prices	change in real prices
1975/74	+ 22.7%	+ 4.9%
1976/75	- 6.8%	- 13.3%
1977/76	- 4.8%	- 11.8%
1978/77	+ 5.7%	- 2.9%
1979/78	- 4.7%	- 12.8%
1980/79	+ 3.1%	- 6.4%
1980/75	- 7.8%	- 39.4%

These data indicate that nominal prices fell by 6.8% in the year following the imposition of controls in the subsequent year. Then over the next three years apartment prices increased by 5.7%, decreased by 4.7% and increased by 3.1%.

Perfect capital markets with a one-time announcement of controls would result in an instantaneous downward capitalization of the value of rental buildings. But the fall in the nominal price of rental units occurred in two stages. This may be a reflection of events associated with controls. The party in power announced in July 1975 that some form of rent review would be introduced. All parties promised some form of controls during the election campaign between August 11th and September 18th. Legislation was introduced in November and enacted in December. However, while the legislation was retroactive to July 1975 it was scheduled to expire on August 1, 1977. Shortly before August 1 controls were extended on a temporary basis for one year as all parties supported the continuation of controls and were eventually made "permanent" in late 1979 after several further extensions. It may be that investors in rental property actually believed controls would expire on August 1, 1977. Then when they were extended in 1977 expectations were that controls were here to stay, hence the future stream of net rents would be smaller than originally believed.

Smith and Tomlinson concentrate on the net income stream in the valuation (capital values) of rental units. In fact, the market value of rental units appears to depend on other factors in addition to expected net rental income. These include the tax position of the owner, i.e., the write-offs available by reason of owning rental property that might not be available to other potential buyers. Perhaps more importantly is the opportunity for capital gains when the property is sold. These may be based on the expected value of the land. Rent controls, however, are often accompanied by restrictions on conversion or demolition. Therefore, controls may not only reduce expected net cash flow, but also the residual value of the property by restricting its use.

3.2 MOMAH (1982)

The Ministry of Municipal Affairs and Housing provides data on the median selling prices per unit in buildings having 20 or more units for six boroughs in Metropolitan Toronto between 1970 and 1980. The rates of change are summarized in Table 6-8.

Even allowing for the fact that "some caution must be exercised given the relatively small number of sales" in some years, the pattern of changes in the nominal price of rental units in Table 6-8 is rather different than those reported by Smith and Tomlinson for buildings of six or more suites in the City of Toronto and summarized above. First, median market values rose in two of the

Table 6 - 8

Changes in the Nominal Average Price of Rental Units in Buildings of 20 or More Units in Metro Toronto

Period	Toronto	North York	Etobicoke	East York	Scarborough	York
1974/70	- 3.9%	+ 34.5%	+ 24.1%	+ 14.8%	+ 10.9%	+ 50.5%
1975/74	+ 8.6	- 3.1	+ 2.7	- 8.0	- 1.2	+ 18.4
1976/75	- 3.5	- 10.7	- 31.7	+ 11.4	+ 8.3	- 31.9
1977/76	+ 16.9	+ 4.7	+ 98.4	+ 1.3	- 3.5	+ 53.0
1978/77	+ 4.7	+ 24.7	- 12.9	+ 11.1	+ 15.3	- 26.3
1979/78	+ 1.8	+ 2.9	+ 13.9	+ 19.9	- 8.0	+ 22.4
1980/79	+ 9.2	+ 6.4	- 30.7	- 6.4	+ 14.0	- 2.6
1980/75	+ 31.3	+ 27.7	- 11.3	+ 41.3	+ 26.4	- 8.4
based on an average	+ 5.3*	+ 20.8	na	na	+ 20.1	na

* versus -7.8%, from Stanbury and Thain (1986), for buildings of 6+ units.
na = Data not available.

Source: MOMAH (1982, p. 96) from TEELA Market Surveys Ltd.

six boroughs between 1976 and 1975 while Smith and Tomlinson report a decline of 6.8%. Moreover, for the boroughs that declined in Table 6-8, the typical decline was much larger: -10.7, -31.7 and -31.9%.

Second, in the second year controls were in place, the price of units in Toronto rose by 16.7% according to Table 6-8 (1977/76). Yet according to Smith and Tomlinson nominal prices fell by 4.8%. Table 6-8 indicates that five of six boroughs posted increases between 1977 and 1976: in two cases the increases exceeded 50% but this may be due to the small sample size.

Third, Smith and Tomlinson report that nominal prices fell by 7.8% between 1975 and 1980 for units in Toronto. Table 6-8 indicates they rose by 31.3% over the same period. In fact, they increased in four of the six boroughs in the Metro Toronto area. Increases in North York, East York and Scarborough over the period 1975 to 1980 were 27.7%, 41.3% and 26.4% respectively. See Table 6-8.

4.0 LOSSES TO THE RENTAL HOUSING STOCK

4.1 Introduction

It is frequently argued that rent controls create economic incentives for landlords to try to remove their buildings from the controlled stock. This may be done in several ways:

- conversion to non-rental activities including
  - ownership housing (condominiums, co-operatives or even single family in the case of smaller buildings, called deconversion)
  - conversion to non-housing purposes, e.g., office space
- demolition following which a new structure is built which does not contain any rental dwellings
- major renovation so as to move the units (perhaps fewer units) into an exempt category, e.g., "luxury" units
- reconversion

It is difficult to obtain data on losses to the rental stock in Ontario that might be attributed to rent controls. Klein and Sears et al. (1983, Vol. 1, pp. 60-66) do provide some data for a number of Ontario cities, notably the City of Toronto, between 1976 and 1981.

4.2 City of Toronto

The City of Toronto has the highest fraction of tenant households in Ontario. In 1976 owner-occupied dwellings amounted to 30.9% of the total number of occupied housing units while in 1981 the fraction was 33.3% (Klein and Sears et al. (1983, Vol. 9, p. 5). Owner-tenant dwelling units accounted for 17.6% and 13.6% of the total in 1976 and 1981 respectively. Purely tenant-occupied units accounted for 51.5% of all occupied dwelling units in the City of Toronto in 1976 and 53.1% in 1981. In short, about two-thirds of households in the City of Toronto are renters rather than owners.

Between 1976 and 1981 11,300 new units were added to the rental stock by means of new construction. However, 13,200 units were lost due to demolition, conversion and deconversion. The latter term refers to the process by which rental properties occupied both by tenants and the owner are converted to owner-occupied status without tenants. For example, of the 45,000 units in owner-tenant properties in 1976 only 22,100 remained in this category in 1981. "Of the remaining 22,900 units, 11,000 units had switched to owner-occupier status with no tenants, while 5,600 units have changed to totally tenant-occupied. About 5,700 units were lost due to demolitions, deconversion or conversion to non-residential purposes" (Klein and Sears, 1983, Vol. 1, p. 61). However, there were also a considerable number of switches the other way. "In 1981 there were 7,000 owner- tenant units in what previously were owner-occupied buildings and 5,900 owner-tenant units in what previously were tenant-occupied buildings." It would appear that, on balance, these switches increased the number of rental units.

Table 6-9

Changes in 1976 Assessment Dwelling Stock
City of Toronto, 1976-1981)
(000's of Dwelling Units)

	Occupied Stock by 1976 Tenure					
	Owner-Occupied	Owner-Tenant	Tenant-Occupied	Total Occupied Stock	Vacant	Total Stock
1976 Stock	79.1	45.0	131.8	255.9	5.6	261.5
Changes 1976-1981						
Demolitions and Conversion to Non Residential	- 0.3	- 0.7	- 1.6	- 2.6	- 0.5	- 3.1
Other Reasons	+ 0.3	- 5.0	- 1.0	- 5.7	+ 0.6	- 5.1
1976 Stock Remaining in 1981	79.1 31.2%	39.3 15.5%	129.2 51.0%	247.6	5.7 2.3%	261.5 100%
Stock Remaining in 1981 by Tenure in 1981						
Owner-Tenant	7.0	22.1	5.9	35.0	0.5	35.5
Tenant-Occupied	4.9	5.6	115.0	125.5	2.5	128.0
Total Occupied Stock	77.7	38.8	126.7	243.2	4.9	248.1
Vacant	1.4	0.5	2.5	4.4	0.8	5.2
Total Stock	79.1	39.3	129.2	247.6	5.7	253.3

Source: Housing Occupancy Analysis System, City of Toronto Planning and Development Department. Reproduced from Klein & Sears et al. (1983, Vol. 9, p. 7).

At the same time, 4,900 units switched from owner-occupancy to tenant occupancy while 5,800 units made the opposite move. See Table 6-9.

Klein and Sears et al. (1983, Vol. 1, p. 61) attribute the "severe decline" in the owner- tenant dwelling stock to "the process of gentrification" whereby above-average income households acquire owner-tenant units and "deconvert" them to single family, owner-occupied dwellings. While the term "gentrification" is being used, implicitly, in a pejorative fashion, we should emphasize that the 13,200 rental units lost due to demolition, conversion and deconversion between 1976 and 1981 was a small fraction of the rental housing stock in the City which in 1981 totalled some 181,400 units (35,600 owner-tenant units; 139,300 tenant occupied units and 6,500 vacant units).

Deconversion is described as changing "existing multi-unit homes into homes that contain few units or a single family only". It is also known as "white painting" (p. 63.). Klein and Sears et al. (1983, Vol. 1, p. 64) claim that "the present difficult economic conditions have combined with the process of gentrification, or more importantly deconversion, to produce both social and housing crises for a growing population in our society". They continue, "this population consists of those socio-economic groups which have traditionally found refuge in inner-city accommodation such as rooming houses, multiple unit houses, older apartment buildings and older hotels. This type of housing is disappearing and is not being replaced ..."

But gentrification is hardly the only factor. Klein and Sears et al. (1983, Vol. 1, p. 64) themselves note that "amendments to the Landlord and Tenant Act which granted strong security of tenure protection to tenants have discouraged many homeowners from renting out rooms, particularly in their own homes. ...small landlords are easily discouraged by one bad experience such as considerable frustration and delay in getting a troublesome tenant to move out."

Of particular concern to those advising Klein and Sears et al. are single persons with low incomes for whom no permanent form of housing is provided by governmental assistance. The problem has been complicated by "the release from mental hospitals of a large number of psychiatric patients into the community ..." (p. 65). See Globe and Mail, November 22, 1984, p. 15.

The Housing and Occupancy Survey data cited by Klein and Sears et al. (1983, p. 62) indicates that 3,100 units were demolished or converted between 1976 and 1981; 1600 of these were tenant-occupied in 1976. The Planning and Development Department of the City of Toronto indicates that 1,413 units of all tenure types were lost through demolitions -- hence "almost as much stock is being lost through conversion to non-residential uses as through demolition" (p. 62). The City of Toronto indicates that only 638 units converted from rental to condominium tenure between 1976 and 1981. Klein and Sears et al. (1983, p. 62) conclude: "in total, relatively little rental stock was lost in Toronto because of demolitions and condominium conversions".

4.3 Other Cities

Table 6-10 provides data on the number of conversions and demolitions in four other cities -- assuming that "all row and apartment demolitions and half of other demolitions are rental units".

It indicates that such losses between 1976 and 1981 amounted to between 0.8% of the 1981 stock in Toronto to 4% in Hamilton. However, the other three cities had losses in the range of 1% to 1.5%. In two of these caess, there was a significant net increase in the rental stock over the period 1976 - 1981. Even if all of Toronto's losses due to demolitions or conversion to condos were reduced to zero, the city would still have experienced a slight net reduction in its stock of rental units.

Table 6-10

Demolitions and Conversions, 1976 - 1981

City	Units lost between 1976 and 1981 due to		Total losses as % of 1981 stock	Net change in rental stock 1976 - 1981
	demolitions	condo-conversion		
• North York	600	526	1.2%	+ 7600
• Hamilton	450	1591	4	+ 4200
• Ottawa	500	238	1	+ 5250
• Kingston	80	108	1.5	+ 200
• Toronto	1600		0.8	- 1900

Source: Klein and Sears et al. (1983, Vol. 1, pp. 62-63).

Table 6 - 11

Conversions to Condominium (Existing Units Converted from Rental to Ownership)

Year	Ontario (Units)	Metro Toronto (Units)
1975	586	204
1976	2,190	1,292
1977	2,151	1,059
1978	784	396
1979	915	71
1980	673	138
1981	324	4
1982	236	42
Total	7,859	3,206

Sources: Ministry of Municipal Affairs and Housing and various regional municipalities. As found in MOMAH (1983, p. 24).

4.4 Conversions to Condominiums

Table 6-11 indicates that between 1975 and 1982 some 7,859 rental units were converted to condominium ownership. This amounts to 0.7% of the rental stock in 1981. Two years, 1976 and 1977, account for 55% of all such conversions. Within Metro Toronto 3,206 units were converted over the same period and this amounted to 0.71% of the 1981 stock of rental units. Again the bulk of the conversions to condominium tenure (73%) occurred in 1976 and 1977 -- the first two full years controls were in force.

4.5 Demolition/Conversion Controls

In an effort to prevent losses to the existing rental stock, particularly of units that provide shelter for low-to-moderate-income tenants, some local governments have moved to enact strict controls over demolitions and conversions. The most stringent of these controls has been enacted by the City of Toronto. Not surprisingly, as the city with the lowest vacancy rate among Ontario cities, these local controls have produced a cause celebre -- the three 5-storey apartment buildings on Eglinton Avenue West owned by Ben Axelrod. The properties were acquired in 1977 and 1978 for $2.2 million in the hope of tearing them down and replacing the 135 units with 90 luxury condominiums. Mr. Axelrod first applied for a building permit in 1980. He was turned down by the City and later by the courts in 1981. Subsequently in 1981 the Ontario Municipal Board ruled against a City by-law prohibiting Axelrod's proposed project. In October of 1981 the City voted to ask the Province to introduce legislation that would allow the City to refuse demolition permits on buildings with 6 or more units as long as rent controls were in force. In May 1983 the Legislature enacted a bill that would permit only a one-year moratorium on demolitions (see City of Toronto Act, c. Pr 6). However, under subsection 11 of the Act, the City "may acquire by purchase, lease or otherwise any land that is the site of a residential property or part thereof that is subject to a refusal [to demolish] undersubsection (2)". The basis for the acquisition price is not stated in the Act.

Mr. Axelrod went to the county court and the Court ordered the City to issue him a building permit. Axelrod then appealed the provincial legislation to the Supreme Court of Ontario and applied for a demolition permit. The Supreme Court ordered that the permit be granted because the dispute had preceded the legislation.

The City then appealed but the Court of Appeal upheld the lower court's order that the demolition permit be granted. Five days later (November 6, 1984), officials at City Hall refused to issue a demolition permit. Three days later Axelrod charged the City with contempt of court. The City of Toronto was fined $100,000 after 11 aldermen walked out of an emergency meeting of City Council rather than vote to give Axelrod a demolition permit. A further fine of $15,000 was imposed for every day the City delayed issuing the permit. Finally, on November 10, 1984 City Council voted to issue the permit and also agreed to try to buy the three buildings for a senior citizen co-op if the federal and provincial governments provided the money. In December 1984 some 45 applications for demolition permits representing about 1500 apartment units were said to be before the City of Toronto. In May 1985, the City Council of Ottawa was considering an Interim Bylaw to control demolition.

The Globe and Mail (November 16, 1984) editorialized that "clearly, the Eglinton Avenue dilemma is regarded as the Stalingrad of the condominium conversion problem -- the point at which the trend must be stopped and rolled back before moderately-priced housing is lost to the city for ever". The case was emotionally highly-charged because of the age and long residence of many of the tenants. For example, Toronto Star columnist Lois Sweet described the plight of an 80-year old couple who had lived in one of the buildings for 30 years. She quotes a tenant organizer as saying "Everyone knows one another.

People can walk to the synagogue or meat markets. The apartment units are spacious and many have a view to trees and birds. ...This is a neighbourhood with strong loyalties" (November 23, 1984). Columnist David Lewis Stein (Toronto Star, December 19, 1984, p. A6) asked, "what's the dignity of the elderly worth?" noting that over one-half of the tenants in one building were over age 65. He quotes a 70-year old tenant as saying "when you get to our age, it's important for my wife and me to be close to shopping. And people are friendly here." The aged tenant also argued that "I have a right to have a roof over my head that I can afford. And I have a right to live decently."

Kathy English, writing in the Toronto Star (November 17, 1984, p. B4) asserted that "the controversy essentially comes down to a question of private property rights versus the rights of the community". This is, of course, a serious mis-statement of the issue. The rights of "the community" are not at issue here -- indeed, communities as such cannot have rights. They are reserved for individuals. The clash is between the rights of the property owner (a natural person) and the rights of sitting tenants. The issue is just how much security of tenure should they be afforded? Should they be entitled to stay in a rental unit as long as they wish to so long as they pay the rent? Should they have the right to transfer their tenants to someone else, perhaps a relative? [Kathy English, "A question of a person's basic rights", Toronto Star, November 17, 1984, p. B4.]

Alderman Dale Martin, a former president of the Federation of Metro Tenants' Associations, argued that the long-term security of people who can't afford or chose not to own, has to come before property rights. "We have to intervene to protect human beings from individuals pursuing narrow economic interest. I don't think the owner of a building has a right to knock it down if it's going to tamper with the lives of others." Martin sees demolition controls as an extension of security of tenure provisions for tenants. NDP Leader Bob

Rae agrees. He said that the tenant's right to security of tenure "supercedes any rights landlords have with respect to rights of property. Once a property owner makes a decision to rent to someone, they give up certain rights, among them the right to evict tenants in order to demolish." Quite a different view is provided by developer and landlord, Jonathan Krehm, who is quoted as saying, "the only reason why buildings like [Axelrod's] get torn down is because rent controls depress property values to the point that land is worth more vacant because something else can be done with it."

5.0 MAINTENANCE AND CONSERVATION

5.1 Introduction

As we have noted, it is frequently argued on both theoretical and empirical grounds that one of the principal adverse effects of rent regulation is that the quantity and quality of maintenance declines. This occurs -- usually despite efforts by the authorities to prevent it -- because landlords try to reduce their costs and thereby increase their net returns.

It is easier for regulators to control nominal monthly rentals than it is to control the price of a unit of rental services of a given quality. Fallis and Smith (1984a, p. 1) point out that rent regulation schemes "assume that government can actually control the rent (price) per unit of housing service. In fact, this is extraordinarily difficult to do. A unit of housing service is a non-observable construct; it is an abstract idea for the purpose of analysis." In particular, they note that declines in maintenance levels or services to the tenant are hard to identify, measure and to control by regulation. Landlords may be able to bring supply and demand into equilibrium by effectively reducing the quantity of housing services supplied by a dwelling unit. Steele and Miron (1984, p. 48) make the interesting argument that "a lower level of maintenance accompanied by a lower rent might be positively attractive to low-income households" and that it would improve affordability. They argue that the preferences of low-income households and those of middle- and upper-income renters who prefer the higher level of maintenance, higher rent combination.

On the other hand, the advocates of "moderate" rent controls (e.g., Gilderbloom, 1983c; Gilderbloom and Appelbaum, 1984) argue strenuously that if proper cost pass-through provisions are included in the control's design,maintenance will not be affected by the imposition of controls. Slack and Amborski (1984, n. 15, p. 68) argue that the Ontario rent review system

> appears to provide a very high rate of return for incremental maintenance investments. For capital expenditures, an allowance for interest is built into the rent permanently. Furthermore, to the extent that rents are held down, the landlord can be assured that the market will bear a rent increase. The only disincentive to increasing maintenance expenditures is the adminsitrative cost and inconvenience of having to obtain approval for rent increases at the Residential Tenancy Commission.

These remarks fail to appreciate the important role cash-flow plays in the decision making of landlords, particularly small landlords. Non-capital maintenance is merely "a wash" assuming they are subject to the cost pass-through provisions. Capital maintenance, which may have a high incremental return produces only a small improvement in cash flow. On the other hand, maintenance expenditures foregone that do not also reduce gross revenues (unlikely in an excess-demand situation) result in an immediate increase in net cash flow. Until a building is sold, the landlord literally lives on the net cash flow. Hence a reduction in maintenance expenditures is perceived as improving the welfare of the landlord. He can either consume any increment or move the cash into an unregulated activity. In effect, this is a way to escape, in part, from controls over moving the building out of the controlled rental stock.

5.2 Maintenance and the Law

Legally, tenants may seek redress for inadequate maintenance under both the Landlord and Tenant Act and the Residential Tenancies Act. Section 96(1) of the former reads a follows:

> A landlord is responsible for providing and maintaining the rented premises in a good state of repair and fit for habitation during the tenancy and for complying with health and safety standards, including any housing standards required by law and notwithstanding that any state of non-repair existed to the knowledge of the tenant before the tenancy agreement was entered into.

The administration of the Landlord and Tenant Act is the responsibility of the federal courts and is beyond the jurisdiction of the Residential Tenancy Commission. The landlord's obligations may be enforced by summary application to a judge of the relevant county or district court.

Section 131(1)(c) of the Residential Tenancies Act provides that in determining the total rent increase that is justified for a residential complex, one of the elements for the RTC to consider is "an improvement or deterioration in the standard of maintenance and repair of the residential complex or any rental unit located therein". This provision is qualified somewhat by RTC Guideline RR-7 which states, in part, that

> A reduction in the standard of maintenance could in some cases lead to a determination of an increase in the total rent justified, if it is established to the satisfaction of the Commission that the costs of maintaining the original standard of maintenance have escalated to the point where the landlord is financially unable to maintain such a standard with the current rent receipts, and where it is felt that in order to upgrade the current perhaps unacceptable standard of maintenance to at least the previous level, would require an increase in rental revenue.

See the case of 111 Raglan Avenue, Toronto, RTC file number 126-47-NY; 4 R.T.C. 52.

With respect to S. 96(1), in Cando Property Management and Stephen Neale (York County Court judgment, November 16, 1984), the Court reduced the rent of 21 tenants by $40 per month for the period January 1, 1982 to October 31, 1984. The tenants alleged non-compliance with the property standards by-law of the City of Scarborough in respect to a general lack of maintenance and repair during a period of reconstruction and repairs. The tenants testified as to "the general depreciation of the aesthetic appearance of the building and the general lack of maintenance and repair both within and without". The tenants had asked that their rents each be reduced by 10%.

Originally, the tenants had proceeded under S. 131(1)(c) in resonse to an application by the landlord under S. 126. Despite testimony that the standard of maintenance and repair had deteriorated due to "'work supplies, cleaning supplies and general junk' [which] had been left in the hallways and laundry rooms during repairs to the walls", the Commissioner did not abate the increase in rent authorized. The Appeal Panel, however, awarded an abatement of $5/month for four months for each tenant. See 4 R.T.C. 50. Unhappy with this award, the tenants then proceeded under the Landlord and Tenant Act.

Tenants in a mobile home park have been able to have a rent increase reduced due to the deterioration of maintenance and repair of the drainage system. See 2 R.T.C. 12.

In the matter of 370 McCowan Road, Scarborough (3 R.T.C. 24) an RTC appeal panel held that S. 131(1)(c) applies to change in the landlord's standard of maintenance and repair during the 12 month prior to the first effective date of an increase in rent.

In the matter of 1250 Brimley Road, Scarborough (3 R.T.C. 5) Commissioner Harrott held that there was no generally accepted legal principle establishing that the standard of maintenance runs with the land on sale. What has to be determined under S. 131(1)(c) is whether the maintenance and repair standard practice by the present owner has significantly changed within the 12 months preceding the hearing. In this case it was found that the new owner practiced "a different and lower standard of maintenance from that of the previous owner".

5.3 Tenant Perceptions: MOMAH Surveys

Empirically, the measurement of changes in maintenance is extremely difficult. Do we measure expenditures which are inputs or do we measure outputs? But what outputs do we measure? Do we focus on cosmetic items, e.g., cleanliness and freshness of public areas and the frequency with which units are repainted, or do we concentrate on structural items such as the plumbing, hot water, heating system and elevators? From whose perspective should maintenance be measured? If we adopt the tenants' perspective not all the tenants in the same building may have the same perceptions either about individual aspects of maintenance or about the "global" rating of the level of maintenance. What weight do we give to landlords' opinion on the present level of maintenance and how it may have changed over time? While they may be experienced observers knowledgeable about standards in the industry generally or in a particular rental market, they are also self-interested. They would be more likely to emphasize input costs and also to point out that even if cosmetic items do not suffer under controls (despite low vacancy rates), major maintenance items of a capital nature may be postponed to the detriment of future service levels (e.g., more frequent breakdowns of major services -- hot water, heating, elevators), or the residual value of the building may be reduced by excessive deferral of maintenance. For this reason we provide some evidence of the need for "conservation" expenditures on high-rise buildings more than a decade old in section 5.6 below.

Between 1976 and 1979 the Ministry of Municipal Affairs and Housing questioned tenants about their perceptions of the general state of maintenance

Table 6-12

Quality of Service and Maintenance -- Tenant Perception

City	Year	Very good	Good or adequate	Very poor	Poor or unstated	Total
		(Percentage of total respondents)				
Hamilton	1977	61.9	22.7	14.1	1.3	100%
	1978	60.0	23.9	15.0	1.1	100
	1979	58.6	26.0	15.4	0.0	100
	1980	n/a	n/a	n/a	n/a	n/a
	1981	65.1	23.5	11.4	0.0	100
London	1977	58.1	28.1	13.3	0.5	100%
	1978	57.0	28.2	14.8	0.0	100
	1979	66.0	23.7	10.3	0.0	100
	1980	n/a	n/a	n/a	n/a	n/a
	1981	69.0	20.7	10.3	0.0	100
Ottawa	1977	61.9	23.6	13.6	0.9	100%
	1978	60.6	24.4	13.7	1.3	100
	1979	60.3	25.9	13.8	0.0	100
	1980	n/a	n/a	n/a	n/a	n/a
	1981	64.1	25.8	10.1	0.0	100
Sudbury	1977	65.6	19.0	13.8	1.7	100%
	1978	68.2	21.6	9.9	0.3	100
	1979	69.6	20.0	10.4	0.0	100
	1980	n/a	n/a	n/a	n/a	n/a
	1981	69.6	18.5	11.9	0.0	100
Thunder Bay	1977	57.8	23.8	15.5	2.9	100%
	1978	64.9	22.5	11.6	1.0	100
	1979	64.5	21.4	14.1	0.0	100
	1980	n/a	n/a	n/a	n/a	n/a
	1981	69.1	21.9	9.0	0.0	100
Toronto	1977	56.1	25.4	17.9	0.6	100%
	1978	56.2	24.6	18.4	0.8	100
	1979	55.6	28.0	16.4	0.0	100
	1980	n/a	n/a	n/a	n/a	n/a
	1981	61.1	23.6	15.3	0.0	100
Windsor	1977	n/a	n/a	n/a	n/a	n/a
	1978	n/a	n/a	n/a	n/a	n/a
	1979	58.8	25.3	15.9	0.0	100%
	1980	n/a	n/a	n/a	n/a	n/a
	1981	71.7	19.4	8.9	0.0	100

n/a = data not available

Source: Ministry of Municipal Affairs and Housing, rental surveys, 1977, 1978, 1979 and 1981.

Table 6-13

Change in Level of Maintenance and Services -- Tenant Perception

City	Year	Better	Same	Worse	Unstated	Total
		(Percentage of total respondents)				
Hamilton	1977	22.3	63.0	13.0	1.7	100%
	1978	18.2	70.7	9.1	2.0	100
	1979	17.8	69.5	12.7	0.0	100
	1980	n/a	n/a	n/a	n/a	n/a
	1981	20.4	67.2	12.4	0.0	100
London	1977	16.2	73.3	10.0	0.5	100%
	1978	21.8	70.2	8.0	0.0	100
	1979	21.3	70.1	8.6	0.0	100
	1980	n/a	n/a	n/a	n/a	n/a
	1981	18.8	69.9	11.3	0.0	100
Ottawa	1977	14.9	72.0	11.4	1.7	100%
	1978	19.0	69.7	9.3	2.0	100
	1979	17.5	73.6	8.9	.0	100
	1980	n/a	n/a	n/a	n/a	n/a
	1981	16.2	71.4	12.4	0.0	100
Sudbury	1977	22.0	68.9	7.9	1.2	100%
	1978	24.1	72.2	3.7	0.0	100
	1979	25.3	67.8	6.9	0.0	100
	1980	n/a	n/a	n/a	n/a	n/a
	1981	17.8	76.3	5.9	0.0	100
Thunder Bay	1977	19.8	70.8	7.0	2.4	100%
	1978	14.7	77.1	7.8	0.4	100
	1979	19.2	73.2	6.9	0.0	100
	1980	n/a	n/a	n/a	n/a	n/a
	1981	21.2	73.1	5.7	0.0	100
Toronto	1977	19.5	63.1	14.5	2.9	100%
	1978	19.7	67.5	11.7	1.1	100
	1979	18.1	67.8	14.1	0.0	100
	1980	n/a	n/a	n/a	n/a	n/a
	1981	18.9	68.7	12.4	0.0	100
Windsor	1977	n/a	n/a	n/a	n/a	n/a
	1978	n/a	n/a	n/a	n/a	n/a
	1979	20.2	67.8	9.0	0.0	100%
	1980	n/a	n/a	n/a	n/a	n/a
	1981	20.1	74.9	5.0	0.0	100

n/a = data not available

Source: Ministry of Municipal Affairs and Housing, rental surveys, 1977, 1978, 1979 and 1981.

and how it had changed in the previous year. These data are summarized in Tables 6-12 and 6-13. MMAH (1982, p. 41) states that:

> The findings invariably were that over half of the tenants found maintenance to be good or very good and about one-quarter found it to be adequate, with only 10 to 20 rating it poor or very poor. In addition, most tenants [about two-thirds] did not notice any year-to-year change in the quality of maintenance and of the minority who did, more indicated improvement than deterioration.

The Ministry (1982, p. 42) indicates that the size of the sample in 1979, for example, ranged between 562 and 905 per city in respect to Table 6-12. Several points should be noted about the data in Tables 6-12 and 6-13. First, the fraction of tenants describing the current quality of maintenance and services as "poor" or "very poor" is less than one-sixth. Almost double that fraction describe maintenance as "very good". Second, more than two-thirds of all tenants who had been in the building more than a year indicated that the level of maintenance had not changed during the past year. Moreover, the fraction reporting a little or a lot of improvement was double that saying maintenance had deteriorated a little or a lot.

Third, some 40% of tenants moved during each of the years and their opinions on possible changes in the quality of maintenance were not obtained. Perhaps some of them moved because of a decline in maintenance standards. The data cited in our discussion of mobility does not indicate that this was an important reason to explain why tenants move. Fourth, the 1979 Survey, for example, was done only three years after rent controls were imposed in Ontario. Given that (i) much of the rental housing stock is fairly young (e.g., high rises built in the 1960s and early 1970s -- see Table 6-19 below); and (ii) that maintenance expenditures necessiating rent increases above the statutory rate (first 8% then 6%) can be "passed through" to tenants if approved by the regulator, we would be surprised to find a marked deterioration in the level of maintenance as perceived by tenants.

Fifth, we note that when they were enacted in December 1975, controls were scheduled to expire in August 1977. While they were extended for short periods several times, it was not until late 1979 that they were made "permanent", i.e., without expiration date. Therefore, it may well be the case that landlords made no change in their maintenance activities because they expected rent controls to be short-lived.

Sixth, we note that landlords may have reduced non-cosmetic maintenance, but insufficient time had passed for the adverse consequences to show up for tenants. For example, by eliminating the usual preventative maintenance with respect to weatherproofing or the heating air conditioning systems tenants may not experience leaks or a loss of heat for several years. In one sense, adequate maintenance is like the dog that did not bark in the Sherlock Holmes story. It is the absence of proper maintenance that is noticed -- but usually only with a considerable lag. In a province in which about 40% of tenants turn over each year it may be difficult for tenants to assess changes in maintenance. Steele and Miron (1984, fn. 40, p. 98) make the same argument, but they also suggest that any decrease in maintenance may have taken the form of reduced decorating expenditures rather than "basic structural maintenance" which would affect the capital value of the building.

Seventh, despite the methodological limitations we have noted, it is an important finding that the tenant surveys show such consistent responses over a five year period -- and across a number of cities. The fraction of tenants rating the present level of maintenance to be "very poor", for example, has stayed in the range of 10% to 18% for over half a decade and in as many cities. Similarly, the fractions of responses in each of the three categories, "better", "same", and "worse" with respect to changes in the level of maintenance have been remarkably stable as Table 6-25 attests.

Other surveys: A survey of 293 tenants in 30 buildings in Scarborough between November 1983 and January 1984 found that 21% of tenants rated maintenance in their unit as a "minor problem" while 28% rated it as a "great problem". The comparable figures for the building as a whole (e.g., hall, elevator, etc.) were 30% and 33%. Schwar (1984, p. 5) states that "more than half of the buildings ... showed serious signs of neglect and disrepair. ...[Yet] there was no major cost difference between well-kept and neglected buildings." The most important reasons for choosing their apartment, among the ten listed, in terms of the fraction ranking the item as "very important", were as follows:

price	63%
close to transportation	45%
general maintenance of the building	53%
close to schools	32%
close to job or business	30%
close to shopping centre	31%

In a survey of 500 tenants in North York in 1975 tenants were asked to rate their degree of satisfaction with maintenance. The results were as follows:

unsatisfactory/poor	25%
acceptable	26
satisfactory/very satisfactory	49

The comparable figures for "satisfaction with the building" were 19%, 36% and 46% respectively. These tenants identified the following as among the three most important problems with apartment living (p. 16):

rent increases	66%
maintenance	26
cost of unit	16
noise	16
no problems	11

5.4 The 1981 Building Maintenance Study

In order to obtain a more detailed and reliable indication of the maintenance of rental buildings in Ontario the Ministry of Municipal Affairs and Housing commissioned a large scale study by Social Policy Research Associates. It is reported in MOMAH (1982, Ch. 3) and Blatt (1982b).

5.4.1 Methodology: The highlights of the study's methodology are as follows:

(1) A random sample of rental buildings in Metro Toronto with 20 or more units stratified by age and size was chosen. The survey was confined to Metro Toronto because of resource limitations, because Toronto is the province's largest city with the greatest number of renters, and because Toronto had the highest incidence of poor and very poor ratings of maintenance in 1979. See Tables 6-12 and 6-12.

(2) The study was confined to buildings of 20 or more units for three reasons: smaller buildings would differ considerably in structure; response rates would be lower; and a desire not to impose a complex survey on landlords with limited holdings.

(3) The sample consisted of 307 buildings so that the same number of landlords were interviewed and site visits by consultants were made. From 164 of these buildings a random sample of 5363 tenants replied to a mail survey, a response rate of 77%. The response rate for landlords was 74%.

(4) The pre-test was done in November and December 1980 with the main survey in April-June 1981.

(5) The questionnaire design focused the attention of tenants, landlords and site visitors upon specific, outcome-oriented questions rather than on subjective impressions. Tenants were asked 113 questions, landlords were asked 82 questions while site visitors were asked 36 questions. Of these items, 50, 52 and 25 were candidates for the construction of an index of building maintenance. See Figure 6-1 for a listing of the type of questions.

(6) Items were grouped into a number of categories of maintenance activities as follows:

Figure 6 - 1

Comparison of Survey Content Across Areas of Maintenance

1. Variables measured by all three surveys
   - Cleanliness of floors in each of: lobbies, corridors, stairs, elevators
   - Cleanliness of walls in each of: lobbies, corridors, stairs, elevators
   - Cleanliness of garbage rooms.
   - Cleanliness of outdoor sidewalks/exterior grounds.
   - Global maintenance rating.

2. Variables measured by landlord and tenant surveys only
   - Availability of person to deal with maintenance problems (and on-site or off-site location of that person)
   - Plumbing system breakdowns (and number of occurrences and length of longest occurrence).
   - Hot water breakdowns (and number of occurrences, length of longest).
   - Elevator breakdowns (and number of occurrences, length of longest).
   - Heating system breakdowns (number of occurrences, length of longest).
   - Leaks (and whether repaired, and length of time it leaked).
   - Items needing repair/replacement inside units (and whether tenant requested repair, and whether it was fixed satisfactorily).
   - Problems in building (including broken washers/dryers, electrical shutdowns, vandalism, lighting breakdowns, cosmetic maintenance, structure problems, parking area problems security/safety; and number of times problem occurred, degree of inconvenience for tenant, whether fixed satisfactorily).
   - Speed of emergency repairs compared to one year ago.
   - Speed of non-emergency repairs compared to one year ago.
   - Quality of repair and care of building structure compared to one year ago (if changed, why).
   - Clearance of snow/ice off sidewalks.
   - Problems with rats, mice, bugs (and whether taken care of).
   - State of repair of paint/wallpaper (not in units).
   - Comparison of janitorial care to one year ago (and what has changed).

3. Variables measured by tenant survey only
   - Adequacy of heat supply.
   - Comparison of level of maintenance and services to one year ago (and what has changed).

4. Variables measured by site visit only
   - Repair of floors in each of: lobby, corridors, stairs, elevators, laundry room.
   - Repair of walls in each of: lobby, corridors, stairs, elevators, laundry room.
   - Cleanliness of floors in laundry room.
   - Cleanliness of walls in laundry room.
   - Cleanliness of washers/dryers.

5. Variables measured by Landlord Survey only
   - Type of person responsible for management of on-site maintenance.
   - Number of full-time, part-time, and occasional maintenance staff.
   - Years present owner owned building.
   - Plans to sell or convert (and reasons).
   - Year building built.
   - Number of units in building.
   - Quality of repair and care of building structure compared to five years ago (if changed, why).
   - Comparisons of janitorial care to five years ago (if changed, why).
   - Inspections of each of: boiler room, drainage system, roof (and how often).
   - Preventive maintenance activities done.
   - Comparison of frequency of inspection to one year ago (and 5 years ago).
   - Delays in repairs or replacements needed (what and why).
   - Obstacles preventing quality maintenance.
   - Changes in provision of special services.
   - Does landlord respondent work on-site
   - Responsibilities of landlord respondent.
   - How often landlord respondent is in building.
   - Years landlord respondent with building.

- major systems: heating, plumbing, electrical, roofs, walls, elevators.
- preventative maintenance -- inspections, replacement and repairs.
- normal repairs to wear and tear on walls, floors, stairs, etc.
- janitorial -- cleanliness of walls and floors in lobbies, corridors.
- response to tenant requests where failure to respond would cause inconvenience.

(7) Considerable effort was made to ensure that the survey was both valid (measuring what it is supposed to measure), and reliable. For example, the temporal reliability on a test-retest basis was .789 for tenants (n=109), .554 for landlords (n=38) and .630 for site visits (n=53). MOMAH (1982, p. 50) states that "these tests generally showed the data to have a high degree of reliability and validity".

(8) The general approach was to combine many individual items into an overall index of the quality of maintenance. In such an index random errors cancel out and a more reliable measure is created.

(9) A factor analysis (a statistical technique that can reduce a large number of items to a small number of factors with which the individual items are highly related) was performed and two key factors were identified; "cleanliness" and "repair/breakdown". For example, for tenants, the first factor included 11 items and the second included 17 items. For tenants, the highest loading variables for the two factors were:

- cleanliness factor: cleanliness of floors in: lobbies (.91), corridors (.91), stairs (.88), elevators (.84); cleanliness of walls in: lobbies (.87), corridors (.85), stairs (.84), elevators (.85); cleanliness of outside areas (.87); cleanliness of garbage room (.87); and global rating of maintenance (.87).

Table 6 - 14

Global Maintenance Buildings of 20 or More Units,

Metro Toronto, 1981

Rating	Landlords*	Site Visitors	Tenants	Tenants weighted by building
Very Good	32.9%	15.3%	27.4%	9.8 %
Good	49.2	65.2	32.5	50.6
Adequate	10.7	n.a.	23.6	34.8
Poor	1.3	15.3	9.9	4.9
Very Poor	1.3	0.6	2.6	0.0
Missing/DK	4.6	3.6	4.0	0.0
TOTAL	100	100	100	100
n	307	307	5363	164

* landlord responses were grouped by the authors as follows: 1-2 = very poor; 3-4 = poor; 5-6 = adequate; 7-8 = good; 9-10 = very good.

Source: Blatt (1982b, pp 7-11) and MOMAH (1982, p. 52).

- major systems and repairs factor: leaks in building (.68); plumbing breakdown (.65); hot water breakdown (.62); problems with repairs to windows (.59); problems with repairs to paint and plaster (.52); and other lower but still significant loadings for other (mostly repair-related) variables such as: heating system breakdown (.44); plumbing problems in units (.45); repairs to washers and dryers (.44), and others (Social Policy Research Associates, September 1981, p. 25).

5.4.2 Findings: Table 6-14 indicates that 82% of landlords rated the overall level of maintenance in the sample buildings as "good" or "very good", while 60% of tenants scored their building's maintenance in the same categories. Tenants and landlords had five categories versus four for site visitors. Eighty percent of independent site visitors rated overall maintenance levels as "good" or "very good" on the four-point scale.

Only 2.6% of landlords, 15.9% of site visitors and 12.5% of tenants rated the overall maintenance as "poor" or "very poor". Two points are obvious. First, over five years after rent controls began in Ontario, only a small fraction of larger rental buildings (≥ 20 units) have an unsatisfactory level of maintenance. Second, landlords rate the overall maintenance of their buildings somewhat more highly than do tenants and independent site visitors.

We found it most surprising that despite the effort put into creating a maintenance index neither MOMAH (1982) nor Blatt (1982b) provide the distribution of the index scores for each of the three raters. From the marginals in two tables in Blatt (1982b, pp. 8, 10) we could obtain the index (which has a mean of 100) for site visitors and for tenants as weighted by buildings. The distributions are as follows:

Maintenance Index	Site Visitors	Tenants
40 - 59.9 points	10	7
60 - 79.9	35	22
80 - 99.9	102	54
100 - 119.9	110	57
120 - 139.9	48	23
140 - 160	2	1
Total	307	164

These data indicate the close agreement on the level of maintenance of larger apartment buildings in Toronto as seen by tenants and independent site visitors.

The researchers did not estimate a multi-variable model to try to explain a building's overall score on the maintenance index. They did, however, do a number of bivariate analyses relating the index score to the age of the building, the rent level, and the size of the building. The strongest relationship was found with respect to the age of the building. While 94% of new buildings (those built between 1976 and 1980) scored above average on the maintenance, only 40.6% of old buildings did so (i.e., those built before 1960). Fifty-one percent of buildings built between 1961 and 1975 scored above average on the maintenance index (MOMAH, 1982, p. 55). There was some difference in the index level by size of building: 38.5% of buildings with 20 - 49 units scored above average on the maintenance index. The comparable figure for the 50 - 199 range was 49.1%, and for the largest buildings (200+ units) the fraction above average was 56.3% (MOMAH, 1982, p. 56). These data suggest that larger buildings are somewhat better maintained than smaller ones.

Similarly, higher rent ($301+ per month) buildings appear to be better maintained than lower rent ones. While 35.9% of buildings with rents under

$300/month scored above average on the maintenance index, 62.1% of higher rent buildings did so. This result is not surprising since buildings with higher rents are likely to be newer and we found that newer buildings usually scored higher on the overall maintenance index.

Another variable strongly associated with a below average score on the maintenance index was whether or not the owner had plans to sell the building (MOMAH, 1982, p. 58) indicates that 88% of owners planning to sell had buildings which scored below average on the index compared with 51% for owners with no plans to sell. This result has to be interpreted with caution because only 26 of 307 building owners indicated they planned to sell. Moreover, as MOMAH (1982, p. 57) explains, it is not entirely clear what this indicates in that several possible explanations exist: both poor maintenance and desire to sell may be related to some other factor such as low profitability; once a decision to sell is made landlords lose interest in maintaining the building; and after a building deteriorates, landlords want to get rid of it.

The survey was able to identify that the existence of several types of breakdowns of major services are more frequently associated with buildings scoring below average on the overall maintenance index. These breakdowns related to plumbing (no water for 6 or more hours), hot water (none for 6+ hours), roof leaks (more likely to affect those on the top floor), heating, and elevators (out of operation, causing an inconvenience. Blatt (1982, p. 37) notes that while buildings not having breakdowns scored about evenly above and below the mean for the overall maintenance index , those having a break down in these categories scored below the mean in a significant percentage of cases 73% to 89% in all but a breakdown in hot water . When the verbal overall ratings are used, breakdowns in plumbing, leaks, and heating are most clearly associated with "poor" or "very poor" maintenance ratings. Blatt (1982, p. 42) notes, however, that "there is no relationship between what the landlords said about breakdowns and what the site visitors noted about general conditions i.e., global maintenance ratings. "

The study found that the fraction of tenants in a building reporting that the superintendent is available on a 24 hour basis is positively related to the buildings' score on the overall maintenance index. MOMAH (1982, p.57) indicates that the fraction of buildings with an index score of 100 or over increased from 14.6% where less than 50% of tenants report having a 24-hour per day superintendent to 41% where the fraction is 50 to 74.9%, and then to 62% where more than 75% of tenants in the building say they have a superintendent available on a 24-hour basis.

5.4.3 Changes in Maintenance: In the 1981 survey tenants were asked to compare the present quality of maintenance with that one year earlier. (The high rate of turnover precluded a longer retrospective.) Table 6-15 indicates that over the four specific areas of maintenance, about 90% of tenants said that maintenance had not changed in the last year. Moreover, the fraction reporting a higher level of maintenance outweighed those reporting that maintenance had worsened. These data when compared to those in Table 6-24 which indicate that a substantially higher percentage (some 23 points) of tenants in Metro Toronto said maintenance was unchanged in 1981 than was the case in 1979.

A higher percentage of landlords (Table 6-16), as compared to tenants, said that maintenance was both better and worse in the past year. Over the five categories the fraction rated as "better" ranged from 11.3% to 23.7% while the percentage indicating maintenance was "worse" ranged from 3.5% to 10.8%. Overall, over 70% of landlords rated maintenance as unchanged over the previous year.

Table 6-15

Tenant Perceptions of Changes in Maintenance in Last Year

Question	Better (Per Cent of Buildings)	Same	Worse	Total
• Janitorial	6.3	92.6	1.0	100.0
• Quality of Repair	7.3	87.8	4.9	100.0
• Speed of Major Repair	4.0	93.2	2.9	100.0
• Speed of Minor Repair	4.0	90.1	5.9	100.0
• Overall Maintenance	6.4	91.3	2.2	100.0

Note 1: Percentages based on weighted tenant sample, excluding missing data. Raw data from Social Policy Research Associates weighted by Ministry of Municipal Affairs and Housing.

Note 2: Categories may not equal 100% due to rounding.

Table 6-16

Landlord Perceptions of Changes in Maintenance in Last Year

	Better	Same	Worse	Other	Total
• Janitorial	23.0	68.6	4.7	3.7	100.0
• Quality of Repair	23.7	69.1	3.5	3.6	100.0
• Speed of Major Repair	19.8	67.1	7.5	5.6	100.0
• Speed of Minor Repair	14.9	69.4	10.8	5.0	100.0
• Inspections of roof, boiler and drainage	11.3	78.2	5.1	5.4	100.0

Note 1: Other includes: question not asked, no response, not in a position to know or repairs not required.

Note 2: Categories may not equal 100% due to rounding.

Source: Based on raw data from Social Policy Research Associates weighted by Ministry of Municipal Affairs and Housing. As found in MOMAH (1982, p. 53).

Landlords were also asked to rate the changes in maintenance over the last 5 years--which coincides with the period rent controls have been in place in Ontario. MOMAH (1982, p. 54) reports the following results:

Maintenance Category	Better	Same	Worse	Total
Janitorial	28.2%	65.8%	5.9 %	100.0 %
Quality of Repair	27.0%	52.8%	20.1 %	100.0 %
Inspections	18.4%	73.5%	8.5 %	100.0 %

We note that in only a small fraction of cases do landlords report that maintenance of their buildings has gotten "worse". The category "quality of repair" had the highest percentage of reductions in maintenance, 20.1%. This fits with the idea that landlords are more likely to do cheaper "patch up" repairs rather than more expensive systematic repairs that would fit into the "conservation" category. For example, a heating boiler may be repaired repeatedly rather than incur the much larger capital expenditure of replacing it and so reduce future annual outlays. In any event, despite five year of rent controls at least twice as many landlords state maintenance has improved as say it has worsened over the past five years. These results are not consistent with the widely-made assertion that rent controls inevitably result in reduced maintenance by landlords.

Landlords were asked in the 1981 survey "Are there any obstacles which prevent you from maintaining this building at the quality level you would like to obtain?" Thirty-two percent said there were no obstacles (MOMAH, 1982, p. 59). Rent review was mentioned as an obstacle by 24% of landlords and 49% said "lack of funds" was an obstacle. What these data seem to indicate is that despite rent review and a lack of funds as obstacles to maintaining their buildings to the quality level they desire, landlords have been, in their own perception, been able to improve maintenance under controls more frequently than they have allowed maintenance standards to decline. Tenants and independent site visitors are less sanguine about the present level of maintenance associated with their building than are landlords. However, on balance, tenants believe--on a year-by-year basis--that more frequently maintenance has improved than has gotten worse.

5.5 Need for Repairs

Tables 6-17 and 6-18 provide data from the Census on the incidence of the need for major and minor repairs to tenant dwellings. The data are only for 1981 and hence do not indicate if the scale of the problem has become worse in the period rent controls have been in effect. They do, however, establish two important points. First, the fraction of rental units needing major and minor repairs varies relatively little by level of rent. (There is one curious exception. Units renting for between $1 and $100 per month have a substantially lower incidence of needed minor and major repairs.) Second, the percentage of rental units needing major or minor repairs varied little across the ten CMAs in Ontario.

5.6 Conservation

Even if the level of maintenance has been little affected by the existence of rent controls since late 1975, landlords may be foregoing expenditures to conserve their buildings. But, as we shall see, it is difficult to distinguish expenditures to conserve a rental building from "ordinary" maintenance expenditures. The importance of conservation expenditures depends, among other things, on the age of the stock, previous maintenance expenditures and the quality of the original construction. A large fraction of the future stock of rental buildings is in existence today. Klein and Sears et al. (1982, Vol. 1, p. 9) note that in the year 2001 three-quarters of the housing stock will have

Table 6-17

Percentage of Tenant Households Occupying Units in Need of Repairs by Monthly Rents, Ontario 1981

Monthly Rents ($)	Minor Repairs	Major Repairs	All Repairs
0	15.0	5.8	20.8
1 - 100	8.9	3.7	12.6
100 - 200	17.4	8.2	25.6
200 - 300	18.3	7.9	26.5
300 - 400	16.3	6.9	23.2
400 - 500	15.3	5.8	21.1
500 - 600	16.0	6.6	22.6
600 - 750	15.1	6.9	22.0
750+	18.5	7.4	25.9
All Households	16.7	7.1	23.8

Source: Statistics Canada, 1981 Census, as found in Pringle (1985, Table 3-14).

Table 6-18

Percentage of Tenant Households Occupying Units in Need of Repairs For Ontario's CMAs, 1981

Census Metropolitan Area	Minor Repairs	Major Repairs	All Repairs
Hamilton	16.6	7.1	23.7
Kitchener	16.3	6.8	23.1
London	15.5	5.6	21.1
Oshawa	15.1	6.5	21.6
Ottawa	15.9	5.5	21.4
St. Catharines/Niagara	17.1	6.8	23.9
Sudbury	17.1	8.8	25.9
Thunder Bay	15.5	7.4	22.9
Toronto	15.8	7.0	22.8
Windsor	14.3	6.5	20.8

Source: Statistics Canada, as found in Pringle (1985, Table 3-15).

been in existence in 1981. In their view, "A particular area of concern ... is conservation of the large stock of high-rise apartment buildings constructed over the past 25 years ... [they] now comprise 40 percent of Ontario's rental stock".

In 1981 there were some 434,000 high-rise apartment units in Ontario and about 290,000 units in low-rise/walk up apartment buildings for a total of 724,000 (versus 3,119,700 dwelling units, 37% of which are renters = 1,154,000 rental units). "less than 20% of the pre-1961 stock of rental apartments was located in buildings of 5 or more stories, while in 1981 40% of Ontario's rental housing stock was comprised of units in buildings of 5 or more stories (Klein and Sears et al., 1982, Vol. 1, p. 5).

The age distribution of rental buildings with 20 or more units in Metro Toronto in 1980 is given in Table 6-19. Sixty percent of these buildings were at least 20 years old while 38% were between five and 19 years old. Compared to New York, for example, the rental stock in Ontario is relatively young, although these data do not include smaller rental buildings, many of which are older than the high rises reported in Table 6-19. A survey of low-rise rental structures

Table 6-19

Size and Age of Larger Apartment Structures in Metro Toronto, 1980

Size	Year of Construction		
	≤ 1960	1961-1975	1976-1980
20 - 49 units	988	79	7
50 - 199	427	576	21
200+	19	256	25
	1434	911	53

Source: Social Policy Research Associates, in Blatt (1982b, Appendix A), p. 49.

in Metro Toronto in mid-1975 (those containing 1 to 7 rental units) indicated that their average age was 57 years for corporate rental buildings and 53 years for non-corporate rental structures (Ministry of Treasury, Economics and Intergovernmental Affairs, 1975, p. 17). With the exception of six-plexes, the average age by number of rental units, ranged from 53 years (single family homes) to 59 years (four-plexes). For some reason six-plexes are younger -- averaging only 41 years as of mid-1975.

These data suggest that as of 1980 the average age of the low-rise stock was about 60 years while that for the high-rise stock was about 25 years. To gain some perspective we note that in 1981 the age distribution of the rental stock in New York City was as follows:

year of completion	%
1978 - 1981	1.0
1970 - 1977	7.1
1960 - 1969	12.8
1947 - 1959	16.8
≤ 1946	62.3

(Stegman, 1982, p. 66).

Klein and Sears (1983, Vol. 10, pp. 5-6) try to distinguish conservation from maintenance expenditures. They say that building conservation involves

- long term measures needed to preserve the life of a building over an identified period of time so that it can be safely used and enjoyed; and
- measures to prevent premature decay or loss of the building or its parts (through neglect), i.e., what is sometimes called preventative maintenance.

They indicate that conservation actions, like maintenance, are largely governed by the initial adequacy of construction. Conservation expenditures include those for weather protection, to ensure structural integrity, the renewal of building systems, capital expenditures on parking structures, occupant safety, movement systems, and equipment and fitments.

Klein and Sears (1983, Vol. 10, p. 12) state that from their survey "the most effective aspects of maintenance are to be found in the cosmetics of the buildings. Generally buildings are clean and reasonably fresh looking, with the public areas particularly tidy, both indoors and out. Painting is kept up and outdoor landscaping well-maintained." On the other hand, "maintaining existing buildings in a weathertight condition remains a major problem and one which will require large capital costs. Roofs, walls, and windows are all problem areas" (p. 11). They also note that "with the exception of parking garage structures, the essential structural elements of most buildings, those elements which hold up the building, are in sound condition regardless of age and only minimum actions are required to either maintain or conserve these structural parts of buildings." Parking garage structures represent a serious problem of conservation: "a most dangerous element is the deterioration which is happening to suspended garage slabs. If left, these can be a hazard to human life" (p. 11).

Klein and Sears (1982, Vol. 1) sought to estimate the costs of conserving the high rise rental stock (some 434,000 units or 40% of the total) over the next 20 years. Their analysis included seven elements of building conservation.

1. Weather protection:	Water penetration through roofs and walls, flashing failures, caulking, disintegrating wall cladding, window leakage, double glazing.
2. Structural Integrity:	Shelf angle failure, missing expansion joints, balcony disintegration.
3. Building Systems	Boiler failure, inadequate electrical supply, galvanized pipe replacement, ventilation controls, boiler upgrading, conversion to fluorescent lighting.
4. Parking structures:	Slab disintegration, missing waterproof membranes, inadequate drainage, leaking subgrade walls.
5. Occupant Safety:	Firemens' elevators, emergency power, smoke detectors, upgrade fire alarm system.

6. Movement Systems: Elevator vandalism, high maintenance costs.
7. Equipment and Fitments: Countertop replacement, cupboard replacement, retiling bathrooms.

(Klein and Sears, 1983, Vol. 10, pp. 6-7)

They emphasized that their estimates of conservation expenditures would be "in addition to the standard maintenance activities ... over the 20 year period including such things as painting and decorating site development, amenity package repairs and replacements, etc." (Vol. 1, p. 73).

They concluded that the conservation costs would amount to $7000 to $14,000 per unit over the next 20 years in 1982 dollars. Hence the total costs could be as high as $6 billion for privately-owned high rise buildings. In addition, the 61,500 units in high rises occupied by rent-geared-to-income tenants could require conservation expenditures of another $860 million (p. 88).

How much would such conservation expenditures affect the typical tenant's monthly rent? Assuming that

- the cost per unit is $11,700 over 20 years in 1982 dollars;
- the costs are financed by a 15% mortgage with an amortization schedule as dictated by rent review; and
- 40% of the conservation costs were incurred in 1982 with 20% in each of 1987, 1992 and 1997 respectively.

Then if the conservation costs were amortized over 10 years beginning in 1982 the unit's rent would have to increase by $74 per month in 1982 and by a further $37 in 1987. Both of these figures are in 1982 dollars. However, if the conservation expenditures are amortized over 20 years, each unit's rent would have to be increased by $60 in 1982, and another $30 in each of 1987, 1992 and 1997. (See Klein and Sears, 1982, Vol. 1, pp. 76-77).

While expenditures of $10,000 per rental unit for conservation appear to be quite substantial they are modest when compared to the cost of building new units. They would cost at least $40,000 in smaller centres where land is cheaper, to about $65,000 in Metro Toronto. Unfortunately, the study by Klein and Sears et al. (1982) does not make it clear by how much the proposed conservation expenditures would lengthen the service life of high-rise rental buildings -- if at all! Their definition of conservation expenditures is wooly. One re-reads it again and again for any indication that such expenditures -- over and above normal maintenance -- will in fact extend the economic life of high rise buildings. Indeed, theirs is an engineering approach to preserving the high-rise rental stock at some level of quality throughout its life. Both the lifespan and the level of quality are not explicitly defined. It is hard, therefore, to understand exactly what contribution Klein and Sears et al. have made to understanding the relationship between the design characteristics of rent regulation and their effects.

Nevertheless, Klein and Sears (1983, Vol. 10, p. 10) state that "the rent review process has an effect on the attitude which building owners take to major maintenance or conservation needs". They say that, in general, landlords argue that controls restrain building conservation expenditures. Actions are biased toward short-term repairs rather than preventative conservation measures; cosmetic actions; and conservation actions that product a direct pay-back. Yet they conclude that "at this time, there is no visible evidence that rent review is affecting the immediate useful life of the residential rental stock or contributing to immediate concerns with public safety". Klein and Sears (1983, Vol. 10, p. 10) continue, "It is suggested, however, that the patch-up approach will contribute to major problems in the future which may be solved by landlords only at a time when rent review is eliminated or modified". Their conclusion is

> The rent review guidelines are inadequate with respect to the conservation process. The rent review system provides little or no incentive for long-term investments for

> conservation. While many capital cost items related to maintenance and conservation meet the rent review guidelines, the system will only allow costs to be passed through on an as-incurred basis. In contrast, a realistic program of conservation should involve a series of coordinated and well planned actions or steps over a period of several years. In a free market situation, landlords would finance conservation costs out of a reserve fund or out of profits since it would be necessary to prolong the life of structure, an element in future profit-maximization. However, landlords can increase rents beyond 6% in rent control if they can justify increased costs -- but increased profits cannot form part of the justification and the procedure is tedious, costly and uncertain. Therefore, if cost increases can be held below 6%, profits will increase. These economics do not encourage conservation investments (Klein and Sears, 1982, Vol. 1, p. 87).

Quite a different perspective is offered by a Toronto Star editorial (August 28, 1983) which stated that the enormous cost of conservation "is no argument at all for the abolition of rent controls [which] ... serve a worthwhile social purpose". The newspaper argued that there is no reason "for landlords not to keep their buildings repaired on an on-going basis. Rent review legislation will permit building owners to raise $6 billion -- gradually -- for maintenance and repairs."

6.0 THE SUPPLY OF NEW RENTAL UNITS

6.1 Introduction

Ault (1981, p. 66) notes that the argument that rent control discourages the construction of new rental housing "is the one used most frequently to oppose rent control, and it is based on the simple notion that investors in rental housing are motivated by profit considerations". To the extent that rent controls are believed to reduce the level of anticipated profits from the construction of new rental units, they will reduce the future supply of such housing. If demand continues to grow, even at a moderate rate, the leftward shift in the future supply curve will result in a lower vacancy rate and greater pressure on the rent ceiling established by rent controls.

The advocates of rent controls -- particularly "moderate" controls -- argue that where new units are exempt there is no reason why future supply responses should be adversely affected. The rebuttal to this argument is that there is some probability that controls will be extended to include newly constructed units that were previously exempt. This possibility increases the riskiness of investing in new rental housing; hence a higher rate of return will be demanded by potential investors. The effect of the higher required rate of return will be to shift the supply curve leftward meaning that fewer units will be offered at all rent levels than if controls were absent. As we noted in Chapter 3, however, where controls have the effect of reducing the vacancy rate and the intertemporal variation in an investor's net returns, they will tend to reduce risks to landlords.

While most economists argue/conclude that, on balance, rent controls will reduce the future supply of rental units, the matter as seen by policy makers is largely an empirical one. What evidence do we have to indicate that rent controls have "caused" a reduction in the supply of new units since 1975 when they were enacted? Before we turn to the limited evidence and the difficulties in interpreting it, we should refer to the matter of the composition of the supply of new rental units under controls.

The effect of rent controls may be to increase greatly our dependency on the public sector for the supply of new rental housing and to reduce the role of privately-initiated, non-subsidized rental housing. In other words even if the total supply of new rental units is little affected by rent controls, the private rental housing market may atrophy after decades of controls. This has occurred in the United Kingdom as the following data on the housing stock make clear:

Tenure		
• Private rental	61%	10%
• Municipal Gov't. rental	12	32
• Other rental	--	2
Total rental	73%	44%
• Home ownership	27%	56%

Source: Patterson (1985, p. 92).

There are two major issues here. First, there is the philosophical issue associated with more government intervention in Canada where we already have what has been described as a "government-centred society". See Howard and Stanbury (1984). The effect of the atrophication of the private rental housing market is to politicize another important area of economic activity and to do away with the efficiency-inducing properties of competitive markets. Second, there is the obvious matter of the public expenditures (subsidies or direct purchases) and tax expenditures involved in increasing the supply of rental units. CMHC (November 1983) indicates that the present value of subsidies per unit occupied by the low-income households in certain of its co-operative housing programs amounts to $54,000 -- or only $2000 less than simply giving the unit away!

Even if the subsidies or tax expenditures (tax revenues foregone) amount to $10,000 per unit, the annual cost to stimulate the construction of 15,000 new rental units would be $150 million. This would be in addition to the over $300 million currently spent through the Ontario Housing Corporation to subsidize rent-geared-to-income housing.

Patterson (1985, p. 32) argues that the public cost of rent control in the form of subsidies for new units is a "vast and growing cost [but] we are seeing only the tip of the iceberg and just a hint of things to come. This is because the public take-over of rental supply has not yet been cranked-up yet." He notes that the Assisted Rental Program (ARP) established in 1975 provided a one-time subsidy of $600 per unit. In 1981, one of its successors, the Canada Rental Supply Plan (CRSP), provided the equivalent of roughly $1,100 per new unit annually for 15 years or a present value of $8,700. The Non-Profit Coop Housing Program provides an annual subsidy of roughly $3,600 for 35 years for a present value of $47,000 (Patterson, 1985, pp. 35, 36). See also Clayton Research (February 1984, pp. 7, 9, 11) and Robinson (1984).

6.2 New Rental Starts

Table 6-20 provides data on various types of housing starts in Ontario over the past 15 years. It indicates that total rental starts declined sharply in 1975 from the previous six-year period, although they began to fall noticeably in 1974.

Period	Average annual rental starts
1969 - 74	37,639
1975 - 79	14,259
1980 - 84	14,488

We include 1975 in the post-control period because there was widespread agitation for controls in early 1975 and because Premier Davis on July 30th promised to enact some form of rent review if the PCs were re-elected. Average annual rental starts between 1975 and 1979 -- the first five years after controls were announced -- were 62% below the annual average in the period 1969-74. The average in the last five years (1980-84) was virtually the same as it was between 1975 and 1979.

Is this decrease in new rental starts attributable to rent controls? Smith and Tomlinson (1981, p. 97), who examined the data up to 1980, ascribe the decline largely to controls. They state that:

> Rent control has substantially depressed new rental housing starts in Ontario even though newly constructed dwellings are exempt from the controls. The steady decline in the real cash flow and real capital value of

Table 6-20
Ontario Housing Starts By Categories, 1969 - 1984

Year	Total Row and Apartment Starts	Total Condo. and Rental Apt. Starts	Total Condo. Starts	Total Rental Starts	Non-Gov't Assisted Starts		Govt' Assisted Starts	
					Condo.	Rental	Condo.	Rental
1984	14,445	13,637	3,524	10,113	3,210	3,291	314	6,822
1983	19.972	19,617	2,493	17,124	2,325	4,777	168	12,347
1982	18,581	18,312	899	17,410	808	5,772	91	11,638
1981	20,188	18,904	3,174	15,730	2,285	7,779	889	7,935
1980	16,806	15,338	3,260	12,078	1,711	8,216	1,549	3,862
1979	20,727	19,266	7,328	11,938	1,560	7,711	5,768	4,227
1978	35,154	32,886	11,781	21,105	1,819	6,935	9,962	14,170
1977	48,867	37,422	22,020	15,402	3,522	5,382	18,498	10,020
1976	43,928	39,449	26,992	12,457	6,022	3,691	20,970	8,766
1975	37,756	34,703	24,309	10,394	9,247	3,775	15,062	6,619
1974	45,559	43,180	20,920	22,260	9,777	15,094	11,143	7,166
1973	59,835	56,841	19,794	37,047	9,920	11,114	9,874	25,933
1972	56,764	54,561	8,427	46,134	4,389	39,097	4,038	7,037
1971	51,497	49,597	7,652	41,945	3,586	31,873	4,066	10,072
1970	50,474	48,442	9,881	38,561	3,055	23,982	6,726	14,579
1969	45,962	44,483	3,586	39,897	1,578	27,543	2,008	12,345

Sources: data for 1969 - 1979 from Smith and Tomlinson (1981); and CMHC, Housing Market Reports and Canadian Housing Statistics for 1980-1984.

> existing rental dwellings under rent control greatly reduces the desirability of investing in new rental housing by changing the investment climate and creating fears that controls would eventually be extended with the same consequences to newly constructed projects.

Smith and Tomlinson (1981, p. 99) point out that all provincial governments had some form of rent controls in conjunction with the federal wage and price control program between late 1975 and mid-1978. They also note that "to encourage provincial cooperation in the housing area and partially to mitigate the effects of rent controls on new construction, the federal government in 1975 reformulated and greatly liberalized its Assisted Home-Ownership Program (AHOP) and introduced the Assisted Rental Program (ARP), and the Ontario government responded with the Ontario Rental Construction Grant Program (ORCGP) in 1976." They conclude (p. 100) that, "the use of government housing assistance programs clearly mitigated part of the decline in total multiple unit and total rental housing starts in the early years of rent control, and prevented the declines from being even larger". The "bottom line" for Smith and Tomlinson (1981, p. 100) is as follows: "it is ... clear that rent controls were associated with a substantial decline in both rental and total multiple housing starts in Ontario [see Table 6-20], notwithstanding that newly constructed dwellings were exempt from the controls".

While the "association" may be clear, there were other factors operating in and on the rental housing market that would tend to reduce new rental starts significantly after 1975 for the next decade. There are also other changes that need to be understood if we are to find a causal link between rent controls and rental housing starts in Ontario. We now discuss both of these.

(i) In Ontario ownership housing starts also fell substantially in the decade after 1975. However, the data in Table 6-21 indicates that average annual ownership starts did not change between 1971-74 and 1975-79 (60,391 versus

Table 6 - 21

Housing Starts in Ontario and Canada, 1971 - 1984

Year	Canada Dwelling Starts	Ontario Dwelling Starts	Canada Apartment and Other	Ontario Apt. & Other (greater than 10,000 pop.)	Non-resident building mat. and wage rates index	Ontario Condominium Starts	Ontario Rental Starts	Ontario Ownership
1971	233,653	89,980	106,187			7,652	41,945	48,035
1972	249,914	102,933	103,715			8,427	46,134	56,799
1973	268,529	110,536	106,451	45,436		19,794	37,047	73,489
1974	222,123	85,503	74,025	33,988	136.1	20,920	22,260	63,243
1975	231,456	79,968	70,361	23,664	150.4	24,309	10,394	69,574
1976	273,203	84,682	89,324	23,282	165.7	26,992	12,457	72,225
1977	245,724	79,130	92,327	25,572	179.7	22,020	15,402	63,728
1978	227,667	71,710	77,327	24,532	193.2	11,781	21,105	50,605
1979	197,049	56,887	58,387	13,822	214.6	7,328	11,938	44,949
1980	158,601	40,127	48,329	12,463	234.0	3,260	12,078	28,049
1981	177,973	50,161	61,609	14,160	256.5	3,174	15,730	34,431
1982	125,860	38,508	53,162	13,675	279.3	899	17,410	21,098
1983	162,645	54,939	44,124	14,953	298.3	2,493	17,124	37,815
1984		47,171				3,524	10,113	38,058

Source: CMHC, Housing Statistics, 1983; CMHC Ontario Housing Statistics; Pringle (1985).

60,216). But in the succeeding five-year period average annual ownership starts fell to 31,890 or by 47%. While this pattern is quite different from that of rental starts, it may be explained by some of the other factors we discuss below.

(ii) For Canada as a whole, apartment and other residential housing starts -- almost entirely rental units -- dropped from an average annual rate of 92,148 between 1971 and 1975 to 79,341 between 1976 and 1979 -- a drop of 14%. They then fell more sharply to an average of 51,806 between 1980 and 1983 -- a decrease of 44%. This pattern is much more similar to that of rental starts in Ontario than it is to ownership starts in Ontario (Table 6-21).

(iii)The rate of new household formations is an important determinant of housing demand. In Ontario the average annual number of new household formations declined as follows:

1971 - 76	81,400
1976 - 81	67,000
1981 - 86e	58,400

(MOMAH, 1983, p. 10).

In other words, while annual average rental starts were falling by 62% between 1969-74 and 1978-79, new household formation was falling by 18% between 1971-76 and 1976-81. Although average annual household formation continued to fall (by 28% betwen 1976-81 and 1981-86e), average annual rental starts were the same between 1975-79 and 1980-84.

(iv) Between 1976 and 1981 the average household size in Ontario fell from 3.1 to 2.8 persons and the tenant household headship rate increased by 8% between 1971 and 1981. The important point here is that both total household formation and tenant household formation significantly outpaced the growth in population in Ontario in recent years. However, the increase in the aveage number of new households declined. It is this figure which builders watch most closely. But they also have to pay close attention to interest rates and to changing levels of income.

(v) Our analysis of the data in Table 6-22 indicates that nominal interest rates on five-year mortgages in terms of four-or-five-year averages, rose steadily between 1971 and 1983 as follows:

Period	Nominal interest rate	Real interest rate*
1971 - 75	10.2%	2.8%
1976 - 79	11.2	2.8
1980 - 83	15.9	6.1

However, as these data show, the increase was most substantial in the period 1980-83. If we deduct the annual average CPI to get an estiate of the real interest rate, we find that it was the same in 1976-79 as it was in 1971-75, but it more than doubled in 1980-83 versus the previous two periods. This pattern of real interest rates most closely fits the drop in ownership housing starts in Ontario rather than that of rental housing starts, whose annual average rate in 1980-84 was the same as 1975-79 as we described above.

(vi) The data in Table 6-22 indicates that the annual unemployment rate in Ontario moved steadily upwards between 1971 and 1983. In terms of multi-year averages we found the following:

1971 - 75	5.1%
1976 - 79	6.7%
1980 - 83	8.4%

When this trend is combined with the drop in the number of new household formations, we would expect to see a decline in both ownership and rental starts. This did occur, although, as we have indicated, the pattern in the two types of dwelling starts was quite different.

(vii)The builders of new residential dwellings also have to consider income levels and their rates of increase. Between 1971 and 1975 real income per capita in Ontario (it would be preferable to have it on a household basis) rose

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* Nominal interest rate minus the Consumer Price Index.

Table 6-22

Selected Economic Indicators, 1971-1983

ECONOMIC INDICATOR	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
. % change in real Net National Income per household	4.9	5.2	7.3	4.5	0.0	2.2	-2.5	0.9	2.0	-0.6	-2.6	-8.9	1.7
. % change in personal income per capita in Ontario (current $)	8.5	10.9	13.1	15.9	12.9	12.0	9.2	9.9	10.7	11.4	15.9	9.2	n/a
. average annual wage changes in major collective agreements - without COLA - in manufacturing (%)	n/a	9.6	12.2	16.1	16.4	10.5	7.3	7.8	9.9	12.2	12.6	10.7	5.1
. % change in Consumer Price Index	2.9	4.8	7.6	10.9	10.8	7.5	8.0	8.9	9.1	10.2	12.5	10.8	5.8
. % change in housing price index	4.5	4.6	6.5	8.7	10.0	11.1	9.4	7.5	7.0	8.2	12.4	12.5	6.8
. % change in food price index	1.0	7.6	14.6	16.3	12.9	2.7	8.3	15.5	13.2	10.7	11.4	7.2	3.7
. % change in energy price index	n/a	2.8	9.0	15.2	13.5	15.4	12.2	9.3	9.8	16.0	30.1	19.8	7.8
. 3-month Treasury Bills	3.56	3.56	5.47	7.82	7.39	8.87	7.33	8.68	11.69	12.79	17.72	13.66	9.3
. Interest rate on 5-year conventional mortgages (%)	9.43	9.21	9.59	11.24	11.43	11.78	10.36	10.59	11.98	14.32	18.15	17.90	13.2
. Unemployment rate in Ontario (%)	5.4	5.0	4.3	4.4	6.3	6.2	7.0	7.2	6.5	6.9	6.6	9.8	10.4
. % change in the help-wanted index in Ontario	-0.2	43.3	25.8	13.8	-28.9	-10.8	-2.7	9.3	34.1	1.3	11.5	-47.4	-12.1
. % change in output per person employed	4.1	3.1	3.0	0.0	-1.0	3.7	0.6	1.0	-0.5	-0.7	-0.5	-2.5	n/a
. % change in population in Ontario	2.0	1.4	1.3	1.8	1.5	1.1	1.1	1.1	0.7	0.8	0.6	0.9	1.1

Source: Department of Finance, Economic Review, April 1984 (Ottawa: Minister of Supply) an average annual rate of 4.9%. This is far above the long-term national rate of about 2% or 3%. Between 1976 and 1979 the rate declined to 2.1% and then between 1980 and 1983 (the last year for which we have data) it fell to a rate of increase of 1.0% per annum. The severe slowing of the rate of increase in real income per capita in Ontario would obviously reinforce the effects of the other series (e.g., household formation, unemployment) and militate toward lower rental housing starts independently of controls.

(viii) It would appear that the fall in rental housing starts could not be blamed on more severe inflation in apartment building costs than on the economy generally. Data from Table 6-21 shows that the index for non-residential building materials and wage rates rose by 42.7% between 1975 and 1979 and by 39.0% between 1979 and 1983. Over the same period, the Consumer Price Index rose by 38.0% and 45.2% respectively. In summary, inflation in the costs of new rental buildings was no worse, on average, than the CPI over the period 1975 - 1983.

(ix) Pringle (1985, p. 64) indicates there were about 163,000 condominium starts in Ontario between 1969 and 1979. He continues, "Allowing 1.5 years for construction and sale, and assuming the number of conversions from condominiums to rental equalled the conversions in the opposite direction; the 163,000 units are taken to represent the total number of condominiums occupied in mid-1981." Now here is the important point: "The census reports that 100,000 owners occupied condominiums. Thus, 39 per cent of the condominium units may have been rented [or were vacant]." This high rental rate suggests that the condo starts reported in Table 6-20 actually contain a significant number of "rental" starts. If we assume that one-third of all condominium starts can be thought of as rental units then the number of effectively rented units changes somewhat.

Period	Average condominium starts	Estimated "rental" condo starts	Measured rental starts	"Adjusted" rental starts
1971 - 1974	$14,198	$4,700	$36,847	41,500
1975 - 1979	18,486	6,000	14,259	20,300
1980 - 1984	2,670	900	14,491	15,400

These data for "adjusted rental starts" indicate that rental starts in Ontario dropped by more than 50% in the first five-year period after controls were announced -- from an annual average of $41,500 in the period 1971-74 to $20,300 in the period 1975-79. The rate then fell by a further 25% to $15,400 per year in the period 1980-84. These data stand in contrast to those for ownership starts whose average annual rate did not drop between 1975-79 and 1971-74 but dropped by almost one-half in the next period, 1980-84.

(x) Pringle (1985, pp. 55-56) points out that a number of authors (Clayton, 1981 and 1984; Kalymon, 1981; Smith, 1977 and Smith and Tomlinson, 1981) "discuss events that may have discouraged investment in rental housing". These include:

- amendments to the Income Tax Act in 1972 and subsequently that reduced after-tax profits on rental buildings by ending write-offs against other income and by making capital gains taxable, albeit at one-half the rate of ordinary income;
- the MURB provision introduced in 1974 "partially re-instated the tax shelter aspect for new rental projects". The effect of this provisions, which was eliminated in 1981 the Budget, may have been to offset to some degree the decline in rental starts attributable to other factors such as those described above; and
- the revisions to the Landlord and Tenant Act in 1970 and particularly those in December 1975, by greatly increasing the tenant's security of tenure may have discouraged investment, especially by small landlords

because it became more difficult and costly for landlords to terminate tenancies.

6.3 Changes in the Composition of the Rental Stock

Between 1975 and 1980 Smith and Tomlinson (1981) indicate that not only did the volume of new rental starts fall greatly, but also that the number of privately-initiated (unsubsidized) rental starts fell even more. These private, unsubsidized starts fell from an average of 27,250 per year between 1969 and 1974 to 6,240 between 1975 and 1980. On the other hand, government-assisted rental starts fell only slightly from an average of 8,717 per year between 1969 and 1974 to 8,535 between 1975 and 1980. More striking is the private, unsubsidized starts' share of all rental starts. Between 1969 and 1974 it ranged from 62% to 85%. Between 1975 and 1980 it ranged from 30% to 37% with the exception of 1979 when it was 65%.

Pringle (1985, Figure 4.1) indicates that of the 131,000 new rental units built in Ontario between 1976 and 1981, 45,000 were socially-assisted and 86,000 were privately-initiated. (This latter figure includes rented condominiums and rented ownership dwellings.)

There has been a very substantial growth in social housing in Ontario over the past decade or so. For example, in 1972 the Ontario Housing Corporation had 54,097 units of rent-geared-to-income units under management (30,784) for families and 23,313 senior citizen units). In 1976 the total was 89,075 (43,010 for families and 46,065 for senior citizens). By 1982 the total was 115,524 (47,775 for families and 67,749 for seniors) (MOMAH, 1983, p. 58). In 1972 98.9% of OHC's units were in project-type developments, but this had declined to 85.9% in 1982 (p. 59). Just over one-half the family households in OHC units in 1982 were receiving social assistance; 39% had income from employment (p. 62). Their incomes averaged $9600 in 1981 (p. 64).

In addition to the OHC social housing, there were 40,581 private or municipal non-profit rental units in Ontario in 1982 of which 46% were for senior citizens and 53% were for families (p. 72). It should be noted that not all of the persons in such units had low to moderate incomes (p. 69).

The estimated cost of OHC's rent-geared-to-income subsidies in 1983 was $309 million and the average monthly subsidy was $238 (MOMAH, 1983, pp. 3, 58).

MOMAH (1983, pp. 2-3) indicates that about 20% of Ontario's rental stock of about 1.1 million units in 1982 was developed with direct assistance from government. Most of the approximately 215,000 rental units brought on stream with direct government financial aid have been created in the past 15 years. Moreover, between 1976 and 1981, "direct government subsidies were a factor in 75 percent of the 80,000 new [rental] units constructed" (p. i).

Housing with ongoing government subsidies (socially-assisted housing) account for almost 14% of the province's rental stock (rents or occupancy charges in socially-assisted housing are excluded from rent review legislation) (MOMAH, 1983, p. 111). Pringle (1985, Figure 4.1) puts the number of socially-assisted rental units in mid-1981 at 148,000 or 13.6% of the total rental stock. These units accounted for 60% of the units in the rental stock that were not subject to rent controls.

While economists like Professor L.B. Smith describe higher government subsidies (or other forms of government assistance such as "tax expenditures") as part of the social costs of rent control, its proponents do not. For example, Diana Hunt, president of the Federation of Metro Tenants Associations, sees the issue quite differently:

> Government assistance to landlords did not begin with rent review, nor would it end with the removal of rent review. Municipal and co-operative non-profit housing [paid for largely by the federal and provincial governments] are part of the solution to the housing shortage -- not a cost of

> rent review. ... The inability of the private sector to supply adequate ["decent, affordable"] rental housing has brought on housing shortages, but those shortages cannot be laid at the doorstep of rent review. Long term investment in the stock of affordable housing is needed now from the Province of Ontario to meet our basic need for shelter. (Toronto Star, April 29, 1985, business page.)

6.4 Conclusions

- It is clear that the composition of new rental starts in Ontario has shifted dramatically since rent controls were imposed in December 1975. Smith and Tomlinson (1981, p. 98) indicate that in the six years prior to controls private, unsubsidized rental starts accounted for 72.2% of all rental starts. From 1975 to 1980 the ratio fell to 37.8%. MOMAH (1983, p. i) states that between 1976 and 1981 "direct government subsidies were a factor in 75 percent of the 80,000 new [rental] units constructed".

- While it is clear that total rental starts in Ontario have been much lower in 1975 and later years (see Table 6-20), it is also true that they dropped sharply in 1974 (22,260) which is far below the average of 40,717 between 1969 and 1973. In other words, the slide started in 1974 a year before the extensive agitation for controls began in the spring of 1975 -- see Stanbury and Thain (1984, Chapter 6). In fact, there was over-building of rental units in the early 1970s -- see MOMAH (1983).

- It is less clear how much the imposition of rent controls caused a decline in rental housing starts in Ontario. The following factors -- even in the absence of controls -- would have reduced the demand for or incentive to produce as many rental units annually in the period 1976 - 1984 as were produced annually between 1969 and 1974:

  - the number of new household formations delined from 81,400 p.a. between 1971 and 1976 to 58,400 between 1981 and 1986e;

- real interest rates rose from an average of 2.8% between 1971 and 1979 to 6.1% between 1980 and 1983.
- the average annual unemployment rate in Ontario increased from 5.1% (1971-75) to 6.7% (1976-79) to 8.4% (1980-83);
- real income per capita in Ontario grew at an average of 4.9% per annum between 1971 and 1975. It then fell to a rate of 2.1% (1976-79) and to 1.0% (1980-83); and
- the removal of certain tax advantages and the enactment of tenant security of tenure measures.

• On the other hand, there were a number of factors that, to some degree at least, would tend to offset the factors militating toward a decline in rental dwelling starts:

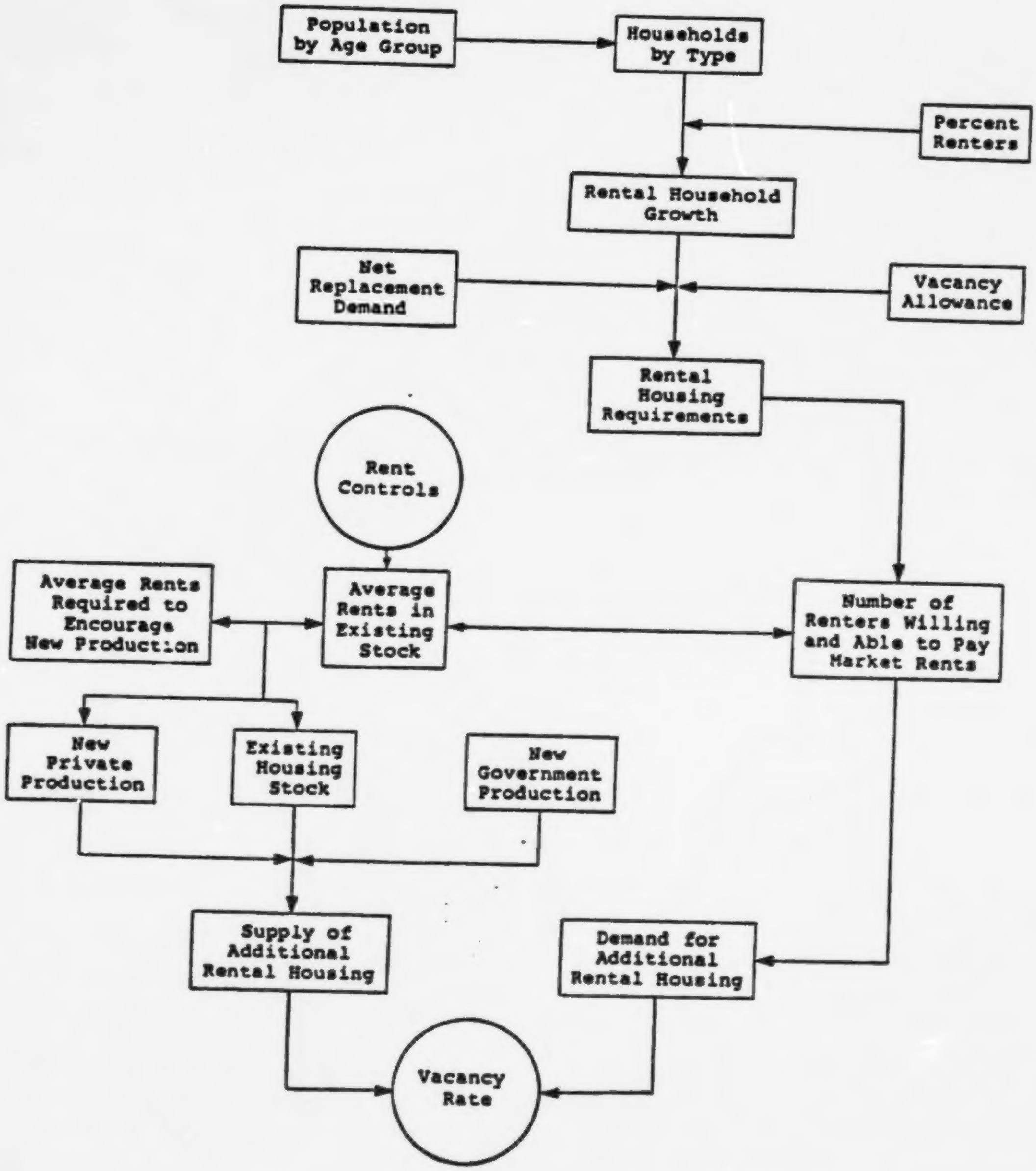
- government subsidies (e.g., ARP, OGCRP) and tax expenditures (e.g., MURB) designed to stimulate the construcion of rental units; and
- increases in rent-geared-to-income housing units supported by one or more levels of government.

• While the influence of rent controls on the supply of new rental housing is debatable, what is clear is that the total supply of rental units has not kept pace with the increase in demand. The evidence for this is the decline in the average vacancy rates in most Ontario CMAs. See Table 6-24 below.

• The factors potentially influencing the number of rental starts is larger than is often acknowledged by some of the critics of rent control. Moreover, the interrelationship among the "explanatory variables" is complex. These points are illustrated by Figure 6-2 prepared by Clayton Research. As complex as it is, this diagram does not specify the economic factors lying behind such terms as "net replacement demand", "number of renters willing and able to pay market rents", and "average rents required to encourage new production".

Figure 6 - 2

SCHEMA OF RELATIONSHIP BETWEEN REQUIREMENTS, DEMAND AND SUPPLY FOR NEW RENTAL HOUSING


Population by Age Group
Households by Type
Percent Renters
Rental Household Growth
Net Replacement Demand
Vacancy Allowance
Rental Housing Requirements
Rent Controls
Average Rents Required to Encourage New Production
Average Rents in Existing Stock
Number of Renters Willing and Able to Pay Market Rents
New Private Production
Existing Housing Stock
New Government Production
Supply of Additional Rental Housing
Demand for Additional Rental Housing
Vacancy Rate

Clayton Research (Nov., 1982, p. 5)

Obviously, these include real per capita or per household income, interest rates and the costs of constructing new rental buildings.

7.0 VACANCY RATES

7.1 Introduction

Vacancy rates are an important indicator of the relationship between the demand for and supply of rental housing. The critics of rent controls are virtually unanimous on the point that controls will, in time, result in a lower vacancy rate than would occur in their absence. The paradox is that it is usually a rapid increase in rents that creates demands for controls. And it is a low-vacancy rate that is associated with large increases in rent.

Marcuse (1979, p.128) notes that if the vacancy rate is low, "there is an absolute shortage of units." There needs to be a certain excess of units available compared to households to permit any significant number of households to move since all households will not move simultaneously and instantly, trading units with the precision of a corps de ballet." (See the discussion in section 7.7 below.) Marcuse states also that "many analysts have held a 5% vacancy rate to be a good approximation for that number of units that should exist, at any time to overcome the 'friction' of moving and to provide a reasonable choice for a given households on the housing market."

It should be noted that a high vacancy rate may not be indicative of a housing market favorable to tenants. The units may be in delapidated buildings, in neighborhoods that are riddled by crime, and consist of units of the "wrong" size for the present characteristics of most households. Moreover, a high vacancy rate may be a symptom of an economically declining area: while the housing stock remains constant in the short run (even for several years) demand is falling in response to declining population or the number of separate households.

Even if a metropolitan area's overall vacancy rate is 4% or 5% suggesting that the rental housing market is roughly "in balance," that single statistic may conceal more than it reveals when the realities of segmentation within the rental housing market are taken into account. For example, the downtown area may have a vacancy rate of under 1% while the neighborhoods further from the core may have vacancy rates of nearly 10%. Moreover, there may be a "mismatch" of supply characteristics (e.g., size, rent level) and the demand side of the market (e.g., the income level and household size of existing or prospective tenants.

7.2 Measuring the Vacancy Rate

The data on vacancy rates in Canada generally is far better than it is in the United States for example. We are able to draw upon the data produced by Canada Mortgage and Housing Corporation. CMHC's Rental Apartment Vacancy Survey is done in all 23 Census Metropolitan Areas twice yearly (April and October since 1975; June and December previously). The universe from which the sample is drawn is that of privately-initiated apartment structures containing six or more units. A vacant unit is one that "is available for immediate rental and physically unoccupied at the time of enumeration." Within the Toronto CMA in October 1984, for example, of an estimated universe of 275,554 privately-initiated units, 229,418 units were sampled.

In the October 1981 survey, CMHC began to distinguish vacancy rates by the age of privately initiated rental buildings. "Old" buildings are those that have been on the market for 19 months or longer. These are surveyed twice a year using a stratified random sample. "New" buildings are those that have been on the market between 7 and 18 months. Normally, CMHC surveys all of these buildings. The "regular survey" vacancy rate combines buildings in the "old" and "new" universe. "This rate is the accepted measure of vacancies in the

Table 6-23

Vacancy Rates in Apartment Structures of Six Units and Over

Publicly and Privately Initiated, in Metropolitan Areas in Ontario, 1971-1984

(Per Cent)

Period		Hamilton	Kitchener	London	Oshawa	Ottawa	St.Cath. Niagara	Sudbury	Thunder Bay	Toronto	Windsor
1971	June	2.0	6.0	6.2	**	2.0	**	0.3	**	2.7	1.8
	Dec	1.9	**	2.3	**	1.5	**	**	**	3.2	1.7
1972	June	2.3	4.7	7.2	**	2.1	2.8	4.9	0.6	2.9	1.4
	Dec	1.6	1.6	4.2	**	1.5	3.3	5.3	0.8	2.3	2.6
1973	April	2.1	5.1	8.4	**	2.0	3.3	9.8	1.5	1.8	2.7
	Dec	2.2	3.6	3.6	**	1.9	4.4	10.7	0.9	1.4	1.9
1974	April	2.1	7.1	5.9	**	3.5	5.2	9.2	1.7	0.9	2.4
	Dec	1.4	2.4	2.0	**	2.0	3.1	2.5	0.6	1.0	3.4
1975	April	1.8	2.8	2.8	**	2.0	3.1	2.5	0.6	1.0	3.4
	Oct	2.9	2.4	2.2	**	2.0	2.6	1.0	0.4	1.5	3.5
1976	April	3.1	3.3	2.8	**	1.9	2.8	0.7	0.4	1.2	3.0
	Oct	2.9	2.6	1.3	**	1.9	1.2	1.2	0.2	1.0	2.2
1977	April	4.1	3.0	1.8	0.7	1.7	1.9	0.9	0.1	1.0	1.5
	Oct	3.9	2.5	1.6	2.0	1.2	1.1	1.0	0.2	0.9	1.0
1978	April	4.0	2.8	1.8	1.5	1.2	1.8	3.0	0.8	0.8	0.7
	Oct	3.3	2.6	2.1	1.4	1.3	1.5	6.1	1.0	0.7	0.9
1979	April	3.3	2.5	3.4	1.8	2.2	2.2	9.9	1.0	1.1	1.4
	Oct	2.1	1.9	4.1	3.6	3.2	2.0	5.4	1.2	1.0	1.3
1980	April	1.9	2.1	5.3	2.6	3.7	2.8	3.2	1.0	1.1	3.1
	Oct	1.5	1.1	3.7	2.2	3.1	1.8	1.9	0.8	0.6	5.5
1981	April	1.3	1.6	3.4	1.0	2.0	1.7	1.6	1.3	0.5	8.2
	Oct	1.1	0.7	1.7	0.0	0.6	0.7	0.5	0.8	0.3	6.9
1982	April	0.7	0.9	2.3	0.2	0.4	1.1	0.6	1.1	0.4	6.4
	Oct	0.6	0.9	2.7	0.4	0.2	1.4	1.3	0.4	0.6	3.1
1983	April	1.3	2.0	3.1	1.1	0.2	2.6	1.5	1.0	1.1	2.5
	Oct	0.9	0.9	2.5	1.3	0.2	0.9	0.4	0.3	0.8	1.7
1984	April	0.8	0.6	2.2	1.3	0.2	0.9	0.7	1.0	0.8	1.1
	Oct	0.7	0.6	1.0	0.3	0.3	0.8	0.6	0.3	0.6	0.9

Source: CMHC, Rental Apartment Vacancy Survey (April 1981; October 1984).

existing rental stock after allowing a reasonable time for rent-up" (CMHC, 1985, p.3). "Newly completed" buildings are those that have been on the market for 6 months or less. All of these buildings are surveyed monthly by CMHC.

Therefore, CMHC, with the exception of data reported in Table 6-25, does not provide vacancy data in the controlled sector (80% of all rental units) separately from the uncontrolled sector. However, the vacancy rate for "new" buildings (measured since October 1981 for the Toronto CMA) provides some indication of that in the controlled sector which consists of buildings which began renting after January 1, 1976. However, "new" units have been on the market only 7 to 18 months. Because they are much newer than the uncontrolled stock as a whole, the measured vacancy rate for "new" units is likely to be higher than the true rate for all uncontrolled units.

7.3 Overall Vacancy Rate for Ontario Cities

With few exceptions, the average vacancy rate for Ontario CMAs has been low (3% or less) since 1981 -- see Table 6-23. Since 1976 -- the first full year rent control was in effect -- overall vacancy rates have declined. Table 6-24 indicates that between 1971 and 1975 in only 13% of the observations (which consists of a CMA measured once every six months) was the vacancy rate 1% or less. However, between 1976 and 1980 the comparable figure was 23%, thenbetween 1981 and 1984 it increased to 59%. Looked at from the other end of the distribution, we find that the fraction of observations in which a CMA's vacancy rate exceeded 3% declined from 32% in 1971-75, to 21% in 1976-80, to only 8% in the period 1981-84. A vacancy rate of 3% is often cited as indicating that a rental housing market is "in balance".

Table 6-24 also reports the distribution of vacancy rates for all CMAs outside Ontario. In the five years prior to the imposition of controls in Ontario (1971-75) we find that for non-Ontaro CMAs 49% of the observations

Table 6-24

Vacancy Rates in Ontario and Non-Ontario CMAs, 1971 - 1984

Vacancy Rate (measured 2X per year)	1971 - 1975		1976 - 1980		1981 - 1984	
	Ontario CMAs	Non-Ontario CMAs	Ontario CMAs	Non-Ontario CMAs	Ontario CMAs	Non-Ontario CMAs
≤ 1%	13%	34%	23%	36%	59%	34%
1.1 - 2.0%	27	15	35	23	26	26
2.1 - 3.0%	27	15	20	13	8	14
3.1 - 4.0%	12	8	14	9	4	13
4.1 - 6.0%	20	16	7	9	4	6
6.1 + %		11		11		7
%	100	100	100	100	100	100
n =	84	132	98	149	80	125

Source: tabulated by the authors from CMHC, Rental Apartment Survey, October 1984 and 1981, Table 1.

recorded a vacancy rate of 2% or less in comparison with 40% for Ontario CMAs. On the other hand, for non-Ontario CMAs 27% of their observations exceeded 4% as compared with only 20% for Ontario CMAs. This would indicate that the variance in the vacancy rate for Ontario CMAs was lower than that for CMAs outside the province. This is confirmed by examining the period 1976 - 80 in which the two groups of CMAs had a similar fraction of observations (58%, 59%) of vacancy rates of 2% or less, but non-Ontario CMAs had 20% of their observations above 4% versus only 7% for Ontario CMAs.

Over the past four years (1981-84) non-Ontario CMAs experienced higher vacancy rates than did Ontario cities. While for Ontario 85% of the observations were 2% or less, that for non-Ontario CMAs was 60%. At the other end of the distribution, for non-Ontario CMAs 13% of the observations were 4.1% or more versus only 4% for Ontario CMAs.

It is clear that vacancy rates for both Ontario and non-Ontario CMAs have declined since 1975. However, the data in Table 6-24 indicates that the decline was greater for Ontario CMAs and that the variance in vacancy rates across Ontario CMAs was lower than that across CMAs outside Ontario.

If we group the data for non-Ontario CMAs by different time periods we find that the intertemporal variation in vacancy rates was greater than Table 6-14 would suggest. Consider the following data for non-Ontario CMAs.

Vacancy Rate	1971-73	1974-77	1978-80	1981-84
≤ 2 %	31%	75%	47%	60%
2.1 - 4.0%	29	16	28	27
4.1 + %	40	9	25	13
	100	100	100	100

7.4 Vacancy Rates in the Controlled and Uncontrolled Sector

As we noted above, it is only very recently that CMHC has provided data on the vacancy rate in the controlled and uncontrolled sectors. Data are available only for the Toronto CMA although it contains a substantial fraction of all rental units in Ontario. (In 1981 43.5% of all households in the Toronto CMA were renters and in the City of Toronto the fraction was 67%.)

The data in Table 6-25 make it clear that (i) the overall vacancy rate in Toronto was low, averaging less than 1% in 1983 and 1984, (ii) the vacancy rate in the uncontrolled sector -- which accounts for one-fifth of all units -- was also quite low: 3.7% and 2.7% in 1984 and 6.2% in April 1983.

The extent to which the vacancy rate for "new" units overstates the vacancy rate for the whole uncontrolled sector can be seen by comparing the data in Table 6-25 with that in Table 6-26. In April 1984, for example, the vacancy rate for uncontrolled units in the Toronto CMA was 3.7% and in October it was 2.7%. The comparable rate for "new" buildings was 16.5% and 7.5% respectively. In April 1983 the rate in the uncontrolled sector was 6.2% while that for "new" buildings -- those on the market 7 to 8 months -- was 14.1%.

Table 6-25

Toronto CMA Vacancy Rates by Rent Control Status

	Under Rent Review	Uncontrolled*	Total
1983			
April	0.6%	6.2%	1.2%
October	na	na	0.8
1984			
April	0.4	3.7	0.8
October	0.3	2.7	0.6

* on market at least 6 months.

Source: CMHC, Rental Apartment Vacancy Survey, Toronto CMA, October 1984, p. 6.

7.5 Vacancy Rates by Age of Building

Table 6-27 indicates that between 1973 and 1984 the average vacancy rate for such "new" buildings was 7.4%. This was almost eight times the rate for "old" buildings -- those which had been on the market for more than 18 months. Table 6-27 suggests that the vacancy rate in "new" buildings (with the exception of April 1977 and April 1979) increased very substantially between October 1982 and April 1984. During this period the rate was over 14% while previously it had been less tha one-half this level. Even if the vacancy rate for "new" buildings is high it does little to increase the overall vacancy rate in the Toronto CMA. For example, if we take October 1983, when the rate for "new" buildings was at its highest point (17.6%) while that for "old" buildings was 0.7% we find that the "old" stock in the CMHC survey amounted to 270,321 units while the "new" stock totalled only 4,655 units. In other words, the high vacancy "new" stock represented only 1.7% of the old plus new. The new stock raised the overall vacancy rate to 1.0% from 0.7 for the old stock alone.

Finally, we note that the vacancy rate for the "new" stock, unlike that for the "old" stock, is subject to large swings reflecting "lumpiness" in new supply

Table 6-26

Vacancy Rates by Age of Building, Toronto CMA, 1980 - 1984

Survey Date		"old" 19+ mos.	"new" 7-18 mos.	regular survey > 7 mos.	newly compl. < 6 mos.	overall universe
1980	April	na	na	1.0%	10.2%	1.1%
	Oct.	na	na	0.5	7.7	0.6
1981	April	na	na	0.4	6.2	0.4
	Oct.	0.3%	0.9%	0.3	0.0	0.3
1982	April	0.3	6.1	0.4	33.2	0.6
	Oct.	0.5	14.3	0.7	13.7	0.7
1983	April	1.1	14.1	1.2	54.3	1.8
	Oct.	0.7	17.6	1.0	49.8	1.2
1984	April	0.6	16.5	0.8	23.7	0.9
	Oct.	0.5	7.5	0.6	26.2	0.8

Source: CMHC, Rental Apartment Vacancy Survey, Toronto CMA (Toronto: CMHC, various issues).

Table 6-27

Vacancy Rates in Apartment Structures of Six Units and Over by Structure Age* Toronto CMA, 1973 - 1984 per cent

Period		Universe** Old	Universe** New	Difference***	Difference/Old
1973	June	2.0	5.0	3.0	1.5
	Dec.	1.5	4.3	2.8	1.9
1974	June	0.9	4.0	3.1	3.4
	Dec.	0.9	4.7	3.8	4.2
1975	Apr.	0.9	5.0	4.1	4.6
	Oct.	1.7	4.3	2.6	1.5
1976	Apr.	1.2	6.0	4.8	4.0
	Oct.	1.0	8.8	7.8	7.8
1977	Apr.	1.0	11.5	10.5	10.5
	Oct.	0.9	4.9	4.0	4.4
1978	Apr.	0.9	1.8	0.9	1.0
	Oct.	0.8	7.4	6.6	8.3
1979	Apr.	1.0	13.2	12.2	12.2
	Oct.	1.0	9.8	8.8	8.8
1980	Apr.	0.9	6.9	6.0	6.7
	Oct.	0.4	2.5	2.1	5.3
1981	Apr.	0.4	1.2	0.8	2.0
	Oct.	0.3	0.9	0.6	2.0
1982	Apr.	0.3	6.1	5.8	19.3
	Oct.	0.5	14.3	13.8	27.6
1983	Apr.	1.1	14.1	13.0	11.8
	Oct.	0.7	17.6	16.9	24.1
1984	Apr.	0.6	16.5	15.9	26.5
	Oct.	0.5	7.5	7.0	14.0
Average		0.9	7.4	6.5	7.2

* For privately initiated buildings excluding buildings constructed within six months of the survey

** Old universe is composed of buildings on the market 19 months or longer; new universe is 7 to 18 months

*** Difference is the new rate minus the old rate

Source: Rental Apartment Vacancy Survey, Toronto Office, CMHC, various years as found in Pringle (1985, Table 2-15).

Table 6-28

Vacancy Rates in Apartment Structures of Six Units and Over by Number of Bedrooms*
Privately Initiated, Toronto CMA, 1973 - 1984
per cent

Period		Bachelor	NUMBER OF BEDROOMS One	Two	Three	Total
1973	June	2.4	1.9	2.2	2.2	2.1
	Dec.	1.4	1.6	1.5	1.5	1.5
1974	June	2.1	1.1	0.8	0.9	1.0
	Dec.	1.3	1.0	0.9	2.1	1.1
1975	Apr.	1.4	1.0	1.0	2.3	1.1
	Oct.	2.0	1.6	1.7	2.9	1.8
1976	Apr.	2.0	1.1	1.5	2.2	1.4
	Oct.	1.5	1.1	1.2	1.8	1.2
1977	Apr.	2.2	1.0	1.1	1.5	1.2
	Oct.	1.6	0.8	1.0	1.4	1.0
1978	Apr.	1.7	0.7	0.9	1.1	0.9
	Oct.	1.8	0.6	0.7	1.4	0.8
1979	Apr.	2.5	1.0	0.9	2.1	1.2
	Oct.	1.6	0.9	1.0	3.0	1.2
1980	Apr.	2.4	0.6	0.8	2.4	1.0
	Oct.	0.9	0.3	0.4	1.4	0.5
1981	Apr.	0.8	0.3	0.3	0.6	0.4
	Oct.	0.4	0.2	0.3	0.5	0.3
1982	Apr.	0.7	0.2	0.4	0.8	0.4
	Oct.	1.0	0.5	0.7	0.8	0.7
1983	Apr.	1.6	0.6	0.9	1.0	0.8
	Oct.	0.9	0.8	1.1	1.5	1.0
1984	Apr.	0.8	0.6	0.9	1.0	0.8
	Oct.	0.8	0.5	0.7	0.6	0.6
Average		1.5	0.8	1.0	1.6	1.0

* For privately initiated buildings excluding buildings within constructed six months of the survey.

Source: Rental Apartment Vacancy Survey, Toronto Office, CMHC, various years as found in Pringle (1985, Table 2-15).

Table 6-29

Vacancy Rates in Apartment Structures of Six Units and Over, By Structure Size*, Toronto CMA, 1973 - 1984

per cent

Period		STRUCTURE SIZE IN DWELLING UNITS						
		6-9	10-19	20-29	30-49	50-99	100-199	200+
1973	June	2.2	1.9	1.2	1.6	1.7	2.0	3.0
	Dec.	0.8	1.5	0.9	1.3	1.2	1.6	2.1
1974	June	0.8	1.0	1.0	1.1	0.7	0.9	1.6
	Dec.	0.7	0.5	0.6	0.8	0.7	1.0	1.7
1975	Apr.	0.3	0.4	1.1	0.8	0.9	1.0	1.9
	Oct.	0.7	1.1	1.1	1.3	1.4	1.5	2.8
1976	Apr.	0.7	1.6	1.1	1.5	0.9	1.4	1.8
	Oct.	0.9	1.1	1.1	1.1	1.0	1.0	1.6
1977	Apr.	0.7	1.2	1.3	1.4	1.0	0.9	1.5
	Oct.	0.5	0.9	1.3	1.1	0.9	1.0	1.1
1978	Apr.	0.5	1.1	1.7	1.1	0.8	0.7	0.8
	Oct.	0.9	1.0	0.7	0.9	0.7	0.8	0.9
1979	Apr.	1.2	1.0	1.9	1.1	0.9	1.2	1.3
	Oct.	1.2	1.2	1.0	1.2	0.8	1.0	1.4
1980	Apr.	1.9	0.9	1.5	1.1	0.8	0.7	1.2
	Oct.	0.6	0.4	0.6	0.8	0.4	0.3	0.5
1981	Apr.	0.9	0.7	0.4	0.6	0.3	0.3	0.3
	Oct.	1.4	0.8	0.4	0.4	0.3	0.2	0.2
1982	Apr.	0.8	0.4	0.5	0.7	0.5	0.2	0.3
	Oct.	0.6	1.0	0.6	0.8	0.6	0.3	0.9
1983	Apr.	0.7	1.1	0.8	1.5	1.1	1.1	1.4
	Oct.	1.0	0.9	0.5	1.0	0.7	1.1	1.1
1984	Apr.	0.8	0.7	0.9	0.8	0.6	0.5	1.0
	Oct.	1.4	0.5	0.8	0.7	0.5	0.5	0.6
Average		0.9	1.0	1.0	1.0	0.8	0.9	1.3

* For privately initiated buildings excluding buildings constructed within six months of the survey

Source: Rental Apartment Vacancy Survey, Toronto Office, CMHC, various years as found in Pringle (1985, Table 2-15).

and irregularities in the pace at which new buildings are absorbed into the rental housing market.

7.6 Vacancy Rates by Size of Unit and Building

Do vacancy rates vary much by size of rental unit? Table 6-28 provides data for Toronto CMA between 1973 and 1984. It indicates that over that period the average vacancy rate for bachelor (1.5%) and three bedroom (1.6%) units was higher than that of one and two-bedroom units (0.8%; 1.0%). Second, at any date of measurement, the absolute vacancy rate for any size of unit never exceeded 3% and the table records 48 observations. In only 14 cases was the vacancy rate above 2%. In short, regardless of the size of the unit, the vacancy rate could only be described as low.

The variation in vacancy rates was even lower by size of building as Table 6-29 attests. The average vacancy rate over the period 1973-1984 ranged from 0.8% for buildings with 50-99 units to 1.3% for those with 200 or more. The typical range in the vacancy rate over time was 0.5% to 1.8%. In summary, we can say there have been no "pockets" or segments of moderate to high vacancies in the Toronto rental market either by size of unit or by size of building. The only "pockets" of higher vacancy rates in the Toronto CMA are those associated with "new" buildings -- those on the market for 7 to 18 months. This point is reinforced by Table 6-30.

7.7 Vacancy Rates Within Metro Toronto

Between 1980 and 1984 the overall vacancy rate in Metro Toronto exceeded 1% on only one occasion (April 1983) and then it was only 1.2% -- see Table 6-30. The overall vacancy rate does not disguise great variations in vacancy rates within the Metro area as Table 6-30 attests. For example, in April 1984 when the overall vacancy rate was 0.8%, the highest rate to be found in the ten jurisdictions reported in Table 6-30 was 2.7% in Mississauga. Only one other jurisdiction (Brampton) had a vacancy rate above 1%.

Table 6-30

Vacancy Rates Within the Toronto CMA, 1980 - 1984

Jurisdictions within Metro Toronto	1984		1983		1982		1981		1980	
	Apr	Oct	Apr	Oct	Apr	Oct	Apr	Oct	Apr	Oct
City of Toronto	0.6	0.6	1.1	0.7	0.5	0.6	0.4	0.4	1.1	0.4
Etobicoke	0.3	0.2	1.5	1.1	0.6	0.9	0.3	0.3	1.9	1.1
York City	0.8	0.4	0.7	0.6	0.3	0.3	0.5	0.3	1.2	0.6
East York	0.1	0.2	0.3	0.1	0.0	0.2	0.1	0.0	0.4	0.3
Scarborough	0.6	0.3	1.5	0.7	0.2	0.5	0.4	0.3	0.9	0.5
North York	0.8	0.3	0.5	0.9	0.1	0.2	0.3	0.2	0.8	0.3
Mississauga	2.7	1.7	3.4	2.6	1.1	2.6	0.8	0.3	0.9	0.6
Brampton	1.5	3.1	3.6	3.0	0.1	0.4	0.8	0.3	0.7	0.5
Oakville	0.5	0.2	1.0	0.5	0.5	0.4	0.1	0.3	0.5	0.3
York Region	0.5	0.2	--	0.4	--	--	--	--	--	--
Remainder of CMA	2.1	1.6	2.9	2.3	0.8	1.8	0.6	0.3	0.9	0.5
Total CMA	0.8	0.6	1.2	1.0	0.4	0.7	0.4	0.3	1.0	0.5

Source: CMHC, *Rental Apartment Vacancy Survey, Toronto CMA* (Toronto: CMHC, various issues).

8.0 DISTRIBUTIONAL IMPACT

8.1 Introduction

In this section we examine the impact of rent controls in Ontario on the distribution of income. It is fair to say that controls are usually instigated by a desire to alter or to prevent a change in the distribution of income. In general terms, the advocates of controls, despite some contrary rhetoric, are supportive of the fact that sitting tenants tent to be made better off as a result of controls while landlords at the time controls are imposed usually suffer capital losses. The fact that not all sitting tenants are poor or "deserving" in some conventional way, and that not all landlords are well off, is ignored by the advocates of controls.

We begin by looking at the economic position of tenants in Ontario; then we examine the estimated impact of controls on the affordability of rental housing. Our main focus is on the distribution of rent benefits (the difference between R_e and R_c) among tenants in both the controlled and uncontrolled sectors. Finally, we review three studies which look at rent control's distributive impact more broadly. They include the distribution of the cost of controls in terms of the decline in the net income of landlords or the owners of companies that hold rental properties.

8.2 Rent-to-Income Ratio

Table 6-31 indicates that in Ontario in 1981 the average rent-to-income ratio of tenant households (77.2% of which lived in a rent controlled unit) was 20.5%. The variation across the 10 CMA's was small, the range being 19.6% to 21.6%. To put these figures in perspective, we note that in New York City in 1981 the median gross rent-to-income ratio was 28.0%, in 1978 it was 28.3% and in 1975 it was 24.7%. Despite rent controls, the median rent-to- income ratio in New York increased from between 19% and 21% in 1950, 1960, 1965, 1968 and 1970 (Stegman, 1982, p.157).

Table 6-31
Rents and Incomes for Tenant Households
Ontario and CMAs, 1981

Area/CMA	Median Annual Income*	Average Annual Income*	Average Gross Rent Payment**	Average Rent-to-Income Ratio
Canada	15,171	17,587	296	20.2
Ontario	15,483	17,752	303	20.5
Hamilton	14,838	16,784	278	19.9
Kitchener	14,706	16,372	274	20.1
London	13,901	15,965	288	21.6
Oshawa	17,471	18,488	314	20.4
Ottawa	16,905	19,406	329	20.3
St. Catharines/Niagara	12,362	14,991	261	20.9
Sudbudy	14,312	15,751	257	19.6
Thunder Bay	14,228	16,686	294	21.1
Toronto	17,150	19,634	340	20.8
Windsor	12,134	14,898	269	21.7
Coefficient of Variation***	0.13	0.10	0.10	0.03

* Refers to 1980 Pre-tax Income

** Refers to mid-1981 Rents

*** Coefficient of variation is the standard deviation divided by the average

Source: Statistics Canada, 1981 Census, 93-942, as found in Pringle, 1985, Table 3-7)

Table 6-32
Rent-to-Income Ratios
Canada, Ontario and the CMAs, 1981

AREA	PERCENTAGE OF HOUSEHOLDS OVER THE RENT-TO-INCOME THRESHOLDS*					
	20%	25%	30%	35%	40%	50%
Canada	53.8	39.8	30.5	24.4	20.1	14.3
Ontario	55.1	38.6	28.8	22.7	18.6	13.4
Hamilton	53.5	38.2	29.1	23.3	19.2	13.4
Kitchener	53.7	37.4	27.6	21.9	18.1	12.9
London	57.9	41.8	31.5	24.9	20.3	15.0
Oshawa	53.7	38.5	28.4	22.9	18.9	14.0
Ottawa	53.9	36.3	26.4	20.7	16.9	12.5
St. Catharines/Niagara	56.5	42.3	33.3	27.3	22.9	16.3
Sudbury	49.5	35.3	27.7	23.1	19.6	14.1
Thunder Bay	56.2	38.9	29.9	24.0	20.1	14.2
Toronto	56.8	38.9	28.3	21.8	17.8	12.8
Windsor	59.7	44.9	35.1	29.2	24.4	18.1

* Excludes households with negative or no household income. Rent for mid-1981; income for 1980.

Source: Statistics Canada, 1981 Census, 93-942, as found in Pringle, 1985, Table 3-10)

Table 6-32 reveals that 38.6% of Ontario renters in 1981 had a rent-to-income ratio greater than 25% - virtually the same as that for the nation as a whole, 39.8%. By comparison, in New York, 56.6% of tenant households spent more than one-quarter of their income on rent in 1981 (Stegman, 1982, p.57). If we use 30% as the point where the rent-to-income ratio becomes "too high", we find that 28.8% of Ontario tenant households exceeded this threshhold in 1981. In New York for the same year, the comparable figure is 45.6% (Stegman, 1982, p.157). We note that by CMA in Ontario the fraction of households whose rent exceeded 30% of their income ranged from 26.4% in Ottawa to 35.1% in Windsor. This difference is largely attributable to differences in average income rather than average monthly rents - see Table 6-31 and Pringle (1985, Table 3.7).

Several points should be noted about these data. First, they do not directly provide any information on the distributional impact of rent controls. They do indicate, however, that the average rent to income ratio of tenants in Ontario is much lower than their counterparts in New York City.

Second, the fraction of tenants who spend more than 30% of their income on rent is 29%, but this figure does not take into account differences in income, i.e., is the ratio high because a household's income is low or because a household with an above average income has chosen to purchase more or better quality housing than others with the same income level. See section 8.3 below.

Third, we note that the average income of tenant households in 1980 ($17,752) was only 58.7% of ownership households ($30,257) whose major housing related monthly payments ($380) constituted a much smaller ratio (15.1%) to income than rent did for tenants (20.5%).

Fourth, these data don't distinguish between tenants who live in a rent-controlled unit (77.2% of the total) and those who live in exempt units, 60% of which live in social housing, the great bulk of which consist of rent-geared-to-income housing. See Appendix B to Chapter 7.

We now try to determine the affect of rent controls on the affordability of rental housing - an important stated objective of controls - see Stanbury (1985a, Ch. 2).

8.3 The Impact of Rent Controls on the Affordability of Rental Housing

While rent controls were introduced in Ontario in 1975 largely in the name of preventing rent "gouging" or "unconscionable" increases in rents during a period of excess demand, one of the principal arguments for their retention has been that they maintain (not increase) the stock of affordable rental housing. As Steele and Miron (1984, p. 1) point out,

> Affordable housing is a major government housing goal and a major public concern. There is a general view that people have a right to housing, that "the right to housing" means more than just the right to shelter, and that one part of the "more" is that housing should be affordable.

In general, an affordability problem is said to exist when the ratio of rent (R) to gross income (Y) exceeds some predetermined standard, usually a figure of about 0.25 or 0.30. In addition, the focus of concern is the ratio of R to Y for low to moderate income households. Middle or upper income households that voluntarily spend one-half their gross income on housing are deemed not to have an affordability problem -- presumably because the absolute amount of income left over after meeting housing costs is sufficient to assure the members of that household have at least an "adequate" standard of living.

Steele and Miron (1984) measure the extent of housing affordability problems in terms of three variables taken together. A household has a housing affordability problem where

(a) it is a renter household;

(b) the household's income is either less than Statistics Canada's definition of the poverty line level of income (or the household income is above the poverty line but below twice the poverty line level income); or

(c) the ratio of rent to income is adjusted for household size, i.e., .40, .30, .25, .225, .20 for households of one to five or more persons respectively.

For 1982 Steele and Miron (1984, p. 15) found that 128,000 Ontario renter households were experiencing a housing affordability problem if the income cut-off is set at the poverty line. If the cut-off is increased to twice the poverty line level of income, the number of households with an affordability problem increased to 166,800 in 1982.

To put these figures in perspective we should note that the 1981 Census indicated there were 1.091 million renter housholds in Ontario. In other words, between about 12% and 16% of renter households were experiencing a housing affordability problem. Note Steele and Miron (1984, p. 83) indicated that their data include only unsubsidized renter households. In other words, they exclude households living in rent-geared-to-income housing or where the capital cost of the unit is/has been subsidized in some way. In 1982, various types of public or subsidized rental units housed about 14% of all renter households in Ontario (MOMAH, 1983).

Steele and Miron (1984, p. 17) provide data indicating that the number of renter households with an affordability problem fell substantially between 1976 and 1980. In urban areas with a population of 100,000 or more the number of problem households declined from 182,000 in 1976 to 122,000 in 1982. In all other areas the number of such households was virtually constant: 43,100 in 1976 and 44,800 in 1982. Note that these figures are based on an income cut-off of twice the Statistics Canada estimate of the poverty line level of income.

Blatt (1982a), in her discussion of affordability (using the 30% cutoff), notes that 65,000 households would drop out of the group as those having problems compared to the 35% definition. The number of problem households increased from 972,000 to 976,000 and then fell in 1978. The total affordability gap more than doubled from 1972 - 1976 then dropped by 21.3% between 1976 and 1978. The average gap-to-income ratio rose quickly to 1976 and then in 1978 fell below the 1972 level.

Steele and Miron (1984, pp. 18-19) offer several reasons why the number of renter households with an affordability problem declined. First, the real income of low-income households rose. The housing affordability problem, as has been noted by Stanbury (1985a) and Fallis (1984) can be just as easily defined as one of inadequate income. Incomes of poor households rose between 1976 and 1982 due to the indexing of government transfer payments, for example.

Second, during the period the price of rental housing services rose more slowly than the Consumer Price Index - recall the discussion in section 2.1 of this chapter. Moreover, disposable income per capita rose by more than twice the increase in the housing component of the CPI. In short, the real price of rental housing fell between 1976 and 1982.

Third, the amount of social housing in Ontario increased during the period. Finally, Miron and Steele point out that the improvement in affordability was not illusory. It was not attributable to a reduction in the quantity of housing services consumed by low income renter households; the incidence of crowding actually declined between 1976 and 1982.

We note that Steele and Miron make no reference to the existence of rent controls as a possible explanation for the reduction in the incidence of the housing affordability problem in Ontario between 1976 and 1982. Yet it may be that rent controls which covered 77% of all rental units in the province in 1981 had the effect of reducing the rate of increase of rents in the controlled sector below what they would have been in the absence of controls -- recall the discussion by Fallis and Smith (1985b) above.

Steele and Miron (1984, pp. 46-47) point out that the impact of rent controls in Ontario may have a different impact on poor households than on the average renter. First, illegal rent increases may be relatively more common among poor tenants than among the more articulate and knowledgeable middle to upper income tenants. Second, the rules of the control system are a disincentive to discounts for long-term tenants -- notably the elderly poor. Yet, even in tight markets, and especially for units in smaller buildings (under 6 units), a fraction of controlled units do not have their rent increased at all, suggesting that tenure discounts operate even under controls.

Third, the cost-pass-through rules favour efforts to obtain larger increases (above the guideline) sooner and then accepting the guideline percentage increases in the future. Sudden, large increases hit the immobile and low income households harder than others: they have lower financial reserves.

The elderly are of particular concern to the advocates of rent control. Steele and Miron (1984, p. 57) conclude that in general terms "it is impossible to say whether or not any of the improvement [in affordability] was an effect of rent review". However, they point out that rent review may have helped the elderly as the number with an affordability problem fell somewhat more than did all other households between 1976 and 1982.

Later they suggest that even if, overall, rents were little affected by controls, some rents were affected. The likely beneficiaries probably live in the core of urban areas, where market rents have risen more than rents in general. They are also likely to be long-term tenants or low-cost households in large, pre-1976, multiple-unit buildings which are highly visible and therefore unable to raise rents illegally (Steele and Miron, 1984, p. 62).

Steele and Miron (1984, p. 78) conclude that "despite our view that rent review has acted only marginally as an affordability policy, we would not argue there should be no rent regulation. We believe there should be protection against unconscionable rent increases". They propose that regulation prevent rent increases of more than 1.5 times the average market increase in the previous year. However, cost-pass-through increases would be more restricted than at present.

8.4 Potential Access of Tenants to Home Ownership

One measure of the economic position of tenants is their potential ability to purchase a home. Recall that in 1980 the average pre-tax income of tenant households in Ontario was $17,600 as compared with $30,300 for homeowners. (For the distribution of tenant households by income, see Table 6-36.) This is a major difference suggesting that many households are tenants because they are unable to buy a house.

CMHC (November 1984) provides estimates of the fraction of renters of primary home-buying age able to afford the average price home in Ontario. The cost of homeownership includes principal, interest and taxes, which must be less than 30% of income before taxes, based on a mortgage with a 25-year amortization, 10% down payment, and the prevailing interest rate. Taxes are assumed to be 1.5% of the market value of the dwelling and lot.

On this basis, CMHC estimates that in 1975, 13.5% of Ontario tenants could have afforded a home. In 1981 this fraction fell to 9.5%, but by 1983 it has increased greatly to 31.3%. These data suggest that in recent years the economic position of tenants has improved markedly as measured by their ability to own a home. Given the number of variables that influence this measure, it is impossible to say whether rent control made any contribution to this improvement.

8.5 The Rent Gap by Age of Unit

Tables 6-33 and 6-34 provide data on average rent levels for units built before 1976 and between 1976 and 1981. Pringle (1985, Table 4.6) indicates that

Table 6-33
Average Rents for Periods of Construction
Ontario and CMAs, 1981

AREA	Period of Construction Before 1976 ($)	 Between 1976-1981 ($)	Percent* Difference (%)	Total ($)
Ontario	277	326	17.6	284
Hamilton	258	301	16.8	263
Kitchener	253	311	23.0	260
London	256	320	25.1	267
Oshawa	296	330	11.5	303
Ottawa	295	374	26.7	305
St. Catharines/Niagara	235	277	17.9	240
Sudbudy	232	285	22.8	235
Thunder Bay	269	295	9.6	275
Toronto	309	373	20.6	317
Windsor	244	329	34.6	259

* Based on unrounded average rent.

Source: Statistics Canada, 1981 Census, 93-942, as found in Pringle, (1985, Table 4-3).

Table 6-34
Average Rents by Household Income for Periods of Construction
Ontario, 1981

Household Income	Period of Construction Before 1976 ($)	 Between 1976-1981 ($)	Percent* Difference (%)	Total ($)
0 - 5,000	211	218	3.0	212
5,000 - 10,000	219	210	-4.0	218
10,000 - 15,000	266	313	17.7	272
15,000 - 20,000	288	349	21.3	295
20,000 - 25,000	306	374	22.1	315
25,000 plus	349	420	20.5	361
Total	277	326	17.6	284

* Based on unrounded average rents.

Source: Statistics Canada, 1981 Census, 93-942, as found in Pringle (1985, Table 4-4).

86.5% of tenant households live in the former while 13.5% live in units built since controls came into effect in 1976. Of course, units occupied by tenants after January 1, 1976 are exempt from controls.

Unfortunately, we cannot directly infer differences on average rents between the controlled and uncontrolled sector from these tables. This is so because we must identify and remove households living in social housing in both pre-1976 and 1976-81 rental units. We do know, however, that of the 941,000 households living in pre-1976 units, 88,200 were living in social housing which is exempt from rent controls. We also know that 60,500 households of the 146,500 living in units built between 1976 and 1981 are living in social housing. This last fact is most interesting. We have noted in section 6.2 of this chapter that a large fraction of all units built since controls were imposed were financially assisted by one or more governments. These data indicate that 41% of social housing units in existence in 1981 were built between 1976 and 1981. In other words, 41% of social housing units were less than five years old in 1981 as compared with 9% of all non-social rental housing units. It maybe, therefore, that one of the effects of rent controls, if it is to stimulate the expansion of social housing, is to provide much newer units for low-income families who live in social housing projects.

Tables 6-33 and 6-34 indicate that new units (both uncontrolled and social housing), on average, rented for 17.6% more than older units (built before 1976) over 90% of which were rent-controlled units. The presence of the social housing units, which rent for somewhat less than the market level, has the effect of understating this measure of difference between rents in the controlled and uncontrolled sectors. Recall that Fallis and Smith (CJE, 1985) found that in Toronto CMA as of November 1982 the nominal difference between average rents in the two sectors was 48%. Recall also that this difference was before quality differences were taken into account and these reduced the observed differential by about one-half.

8.6 The Rent Gap Between Controlled and Uncontrolled Units

We have tried to remove the effect of social housing on the average monthly rents of both the old and new stock in Table 6-34 by making two assumptions: (i) that rents in social housing units are 80% of the market rents in each of the two sectors and (ii) that all households occupying a social housing unit had an income of less than $15,000 in 1980.

Recalculating the data with these two assumptions, we found that the average rent in the uncontrolled sector was $386 while that in the controlled sector was $288 per month. This is a difference of 34%. Recall that for a sample of units in Metro Toronto Fallis and Smith (1985a) found that the gross differential was 48% in November 1982. Both of these estimates, it must be emphasized, do not take into account differences in quality between the newer units in the uncontrolled sector and the older ones in the controlled sector. Fallis and Smith, using hedonic price indices, found that about one-half the gross differential could be attributed to differences in quality between the two sectors. They also estimated that R_e lies about one-half way between R_u and R_c. If we apply both their estimates of the quality adjustment and the relative positions of R_u, R_e and R_c, we find that for Ontario as a whole in 1981 the estimated "rent gap" (R_e-R_c or R_u-R_e) was $25 per month or 8.5%. In other words, after six years of rent controls in Ontario tenant households in the controlled sector paid rents that were, on average, about 8.5% below what they would have been in the absence of controls. At the same time, households in the uncontrolled sector (excluding those in social housing), on average, paid rents 8.5% above what they would have been in the absence of controls. Finally, we note that there were 839,000 tenant households in the controlled sector in 1981 and only 86,000 in the uncontrolled sector excluding those in social housing (148,000) - see Pringle (1985, Figure 4.1).

8.7 The Benefits and Costs of Rent Control Among Tenants

One might naively assume that the total annual pecuniary benefits of rent control to tenant households would be as follows:

$$B = N_c(12)\ R_u - R_c$$

where N_c = number of tenant households living in rent-controlled units

R_u = average monthly rent of units in the uncontrolled sector

R_c = average monthly rent of units in the controlled sector

However, this calculation fails to reflect the insight of Marks (1984b) and Fallis and Smith (1984b). Where a rent control regime has an exempt sector (e.g., new construction, etc.), the equilibrium rent in the absence of controls (R_e) lies between R_u and R_c, i.e.,

$$R_u > R_e > R_c$$

This means that the tenant households unable to live in a rent-controlled unit are "losers" for they must pay more than the market-clearing level of rent. Therefore, the total annual pecuniary benefit (NB) to tenant households associated with rent control is as follows:

$$NB = N_c\ (12)\ (R_e - R_c) - N_u\ (12)\ (R_u - R_e)$$

where N_u = number of tenant households renting in the uncontrolled sectcor

R_e = monthly rent for units of comparable quality that would prevail in equilibrium in the absence of controls.

The next step is to distribute the gains and losses to tenant households by level of income. This recognizes the fact that some low-to-moderate income households pay higher rents as a result of rent control because they live in the uncontrolled sector.

We must emphasize that, as a whole, rent control is a negative-sum game. The net benefits to tenant households come at the expense of landlords, particularly those who own rental buildings when controls are imposed. Therefore, the gains to tenants as a group are offset by losses to landlords. However, because rent control results in allocative inefficiency, it will impose a deadweight burden on society as a whole. In purely allocative terms, the redistribution of income from landlords to tenants (and within all tenant households) uses up real resources. Hence it is a negative rather than a zero-sum game.

A rough estimate of the net benefits of rent control to tenant households in Ontario in 1981 can be obtained from Table 6-35.

$$NB = \$228.2 \text{ million} - \$34.0 \text{ million}$$

$$NB = \$194.2 \text{ million}$$

This estimate, it should be noted, assumes that units in the uncontrolled sector are of the same quality as those in the controlled sector. However, Fallis and Smith (CJE, 1985) found that about one-half of the different between average nominal rents in the uncontrolled and controlled sectors was attributable to differences in quality using hedonic price indexes. Therefore, on a quality-adjusted basis

$$NB^* = .5\ NB$$

$$NB^* = .5\ (194.2 \text{ million})$$

$$NB^* = \$97.1 \text{ million in 1981.}$$

8.8 Tenant Benefits and Costs by Distribution of Income

In Table 6-35 we have tried to estimate the costs and benefits of rent controls in Ontario as of 1981 by level of income. We began with the data in Table 6-34 and then we removed those households living in social housing (assuming that all had incomes below $15,000) and adjusted the reported rent levels by assuming that social housing units rented for 80% of market units. The resulting distribution of tenant households in the rent controlled sector

Table 6-35
Costs and Benefits of Rent Controls to Tenant Households in Ontario, 1981

	Tenant households		R_c	R_u	Gap= R_e-R_c or R_u-R_e	Benefits $000	Costs $000
Household Income	Controlled Sector	Uncontrolled Sector					
≤ $15,000	44.1% 376,000	5.1% 4,400	$249	$266	$8.5	37,740	449
$15,000-$20,000	17.4% 146,000	23.3% 20,000	$288	$349	$30.5	53,436	7,320
$20,000-$25,000	14.4% 120,800	22.9% 19,700	$306	$374	$34	49,286	8,038
$25,000+	24.2% 203,000	49.0% 42,100	$348	$420	$36	87,696	18,187
n=***	839,000	86,000	188*	386*	49**	228,158†	33,994†

* Weighted average.

** Difference between the weighted averages.

*** Totals may not add exactly due to rounding.

† Total weighted by the number of households in each income class where the amount of benefits is computed by income class.

Table 6-36
Distribution of Tenant Households by Income and Age of Household Head Ontario, 1981

Age of Household Head*	PERCENTAGE OF HOUSEHOLDS BY INCOME GROUP ($000's)**						
	0-5	5-10	10-15	15-20	20-25	25+	All Income Groups
15 - 24	16.6	19.4	21.0	16.8	12.7	13.5	16.0
25 - 34	9.0	11.9	16.5	18.5	16.8	27.3	31.5
35 - 44	9.5	12.1	15.0	16.3	15.5	31.6	14.4
45 - 54	11.4	11.4	14.6	14.8	13.6	34.3	10.5
55 - 64	17.9	15.2	15.7	14.4	11.4	25.4	10.0
65+	9.5	48.4	18.3	9.0	5.4	9.5	17.6
All Tenant Households	11.5	19.8	17.0	15.4	13.1	23.1	100.0

* Household head refers to the person, or one of the persons who pays the rent; age in mid-1981.

** Estimates are based on 1980 pre-tax incomes.

Source: Statistics Canada, 1981 census. As found in Pringle (1985, Table 3-8).

and non-controlled sector are reported in Table 6-35. To calculate the pecuniary benefits and costs, we further assumed that $R_e=(R_u+R_c)/2$ following Fallis and Smith (1985a). Finally, in Table 6-39 we have ignored the differences in quality between the two sectors. While this reduces the absolute size of benefits and costs, it does not alter their distribution. Therefore, we are able to state that:

(i) For tenants living in rent controlled units 83.5% of the total benefits went to the 56% of tenant households with an annual income above $15,000 in 1981. The 44% of tenants with incomes under $15,000 received only 16.5% of the total benefits. The 24% of tenants with a household income above $25,000 received 38.4% of the total pecuniary benefits - an average of $432 per household per year. In contrast, households below $15,000 received only about $102 per year in benefits in the form of a rent below the equilibrium level.

(ii) The distinctly non-poor, namely the 38.6% of tenant households in the controlled sector with incomes above $20,000, received 60% of the pecuniary benefits of rent control in 1981.

(iii) While tenants in the controlled sector received some $228 million in rent control benefits, those in the uncontrolled sector (but not living in social housing) paid some $34 million in higher rents because of rent control. Some 77% of the total higher rent payments were made by the 72% of households in the uncontrolled sector with an income above $20,000 in 1981.

(iv) While households with an income below $20,000 (recall the average in 1981 was $17,600) in the controlled sector received some $91 million in pecuniary benefits, those in the uncontrolled sector paid higher rents amounting to about $8 million in 1981.

Fallis and Smith (1985b) study of rents in the controlled and uncontrolled sectors in Metro Toronto in November 1982 indicated that "the ratio of benefits to income falls with income, which can be described as a progressive pattern. The ratio of losses to income falls with income which is a regressive pattern." However, there are four times as many households in the controlled as uncontrolled sector and the average income of households in the controlled sector is 82% of those in the uncontrolled sector. Therefore, overall, they state that rent control is mildly progressive. The distribution of gross benefits, i.e., to those in the controlled sector, indicates that 67% of households had an income (in 1982) of at least $15,000. In other words, the vast bulk of the beneficiaries of rent control (gaining at least $500 per year) are not low income households in whose name controls are maintained. The losers also include low income households in the uncontrolled sector. Nineteen per cent of households in this sector had incomes under $15,000 and they paid about $400 per year more in 1982 for rent than if controls had not been imposed.

We should point out that Fallis and Smith understate the ratio of units in the controlled sector to the uncontrolled sector. In 1981 77.2% (839,000) of all rental units in Ontario were subject to controls. However, of the 248,000 exempt units some 148,000 were socially assisted rental units. While these are exempt from controls, Fallis and Smith's excluded them from their sample which was confined to privately-owned buildings with six or more rental units. Therefore, the ratio of controlled to uncontrolled units is 839,000/86,000 or 9.8 to one, not four to one. This change has the effect of increasing the ratio of gross benefits of rent control to the pecuniary losses in the uncontrolled sector.

Therefore, both studies conclude that the bulk of the gross and net pecuniary benefits go to tenant households which have incomes well above the poor to moderate level and which have no affordability problem. This fact helps to explain why controls are established in the first place and why they persist. The bulk of the saving in the form of lower-than-market rents go to the majority of households that are not poor. See Figure 6-3.

8.9 Distribution of the Costs and Benefits of Rent Control in Ontario

Slack and Amborski (1984) review three studies on the distributive impact of rent review in Ontario:

(a) Fallis (1980) who analyzes the impact assuming controls reduce the price per unit of housing services by 2%;

(b) Miron (1981) who offers a more comprehensive analysis, but also assumes rents are reduced by 1% for the purpose of analysis; and

(c) Blatt (1982a), who also assumes that rents are reduced by 7.5% as a result of controls.

All of these studies include benefits and costs to tenants and the costs to landlords.

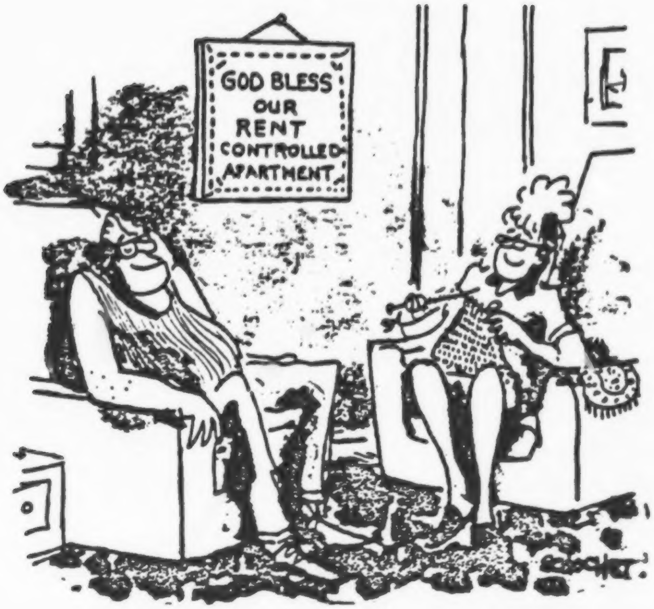
Fallis (1980): Fallis' analysis is based on the 1972 HIFE (Household Income Facilities and Equipment micro data file) data and he examines both the benefits of rent control in the form of the ratio of rent reduction to income and its costs in the form of the investment loss to income by income class. He assumes that investment income is distributed in proportion to income from rents.

Slack and Amborski (1984, pp.28-29) state that

> Fallis' analysis shows that the benefits of rent regulation are progressive among renters, that the pattern of income losses among investors is first regressive and then proportional, and that the combination of the two effects is proportional through the middle- income range, while being progressive at both the upper- and lower-income ranges. This means that rent regulation tends to benefit low-income people and to burden high-income people.

Miron (1981): Miron's analysis is based on 1978 HIFE data as well as MOMAH Housing and Rental Market Survey data. He assumes that the effects of rent

Figure 6-3


GOD BLESS
OUR
RENT
CONTROLLED
APARTMENT

The value of rent control to some individuals is well understood regulation are proportional to the assumed reduction in rents of 1%. He too uses net income from investment to distribute the reduction in rental income among households by assuming that rental income is proportional to net income from investment. Miron attempts to exclude subsidized households in uncontrolled units. Recognizing that a $1 reduction in rent is worth less to a household than a cash grant of $1, he uses two different utility functions to estimate the "real income equivalent" of this rent reduction.

Miron estimates that a 1% reduction in rent produces total savings to renters of $21.2 million in 1978. (The real income equivalent ranges from $20 million to $20.4 million.) The average net benefit per household in 1978, based on a 1% reduction in rents, was as follows:

under $4,000	$6.09	
$4,000- 7,999	3.30	
8,000-11,999	3.64	
12,000-14,999	4.64	
15,000-24,999	3.05	
25,000+	-9.65	(Miron, 1981, p.20)

These results suggest that all households below $25,000 in income are net winners under rent control. As a percentage of income, net benefits are highest among low-income households and they decline steadily up to $25,000, after which they become negative.

If we assume that rent control reduces rents by 10%, then in 1978 the average net benefit per household was only $30 to $61 per year for households whose income was less than $25,000. This seems very small. Slack and Amboroski (1984, p.31) summarize Miron's results for other groupings as follows:

> The analysis by age of the head of the household demonstrates that the overall distribution is from households with older heads to households with younger heads. The analysis by type of household shows the greatest benefits going to those who are young, live alone, are single parents, and have no children. Consistent with the above-noted costs, households consisting of older families suffered the greatest loss of income.

Miron shows that among unsubsidized renter households, subsidized renter households and owner-occupied households it is the last group that suffers the greatest loss (reduction in rental income). About 75% of the total loss is borne by this group. This result appears to be at odds with the several surveys (e.g. Table 7-2) that shows that a substantial majority of homeowners favour rent control. Perhaps they are not aware that they are the biggest losers in the game.

Blatt (1982a): Blatt assumes that in the absence of controls rents would be 7.5% higher. She too uses 1978 HIFE data and her study builds on Miron's. Her estimates suggest that the "benefits of rent review are progressive and that the rent savings as a percentage of income average 2.7 percent for the three lowest income groups [under $12,000] and 0.9 percent for the two highest groups [15,000 and over]" (Slack and Amborski, 1984, p.33). The total rent savings, based on the assume 7.5% reduction in rent in 1978 was $159 million.

Losses are concentrated exclusively in the over $25,000 income group as the following data make clear:

	average net benefit (loss)	% of income
under $4,000	$45.78	1.9 %
4,000- 7,999	24.68	0.4
8,000-11,999	27.48	0.3
12,000-14,999	34.81	0.3
15,000-24,999	22.79	0.1
25,000+	(72.33)	(0.2)

(Blatt, 1982a)

Therefore, average net benefits are destributed in a progressive fashion, i.e. they decline as a fraction of income as income increases. However, because the absolute amount of money redistributed by rent regulation is small (the net beneficiaries get $23 to $46 per household per year), the redistributive impact is small.

Blatt (1982a) found that the greatest benefits accrued to the youngest and oldest age groups while costs were concentrated on the oldest age group as it has the largest investment income per household. Blatt (1982a, p. 39) concludes that

> while redistribution occurs it has so small an impact upon the average household and it is so unfocused in relation to need, as to make it seem a waste of effort. Needy tenants are not receiving a sufficient assitance to solve their problems, landlords are feeling enough of a pinch in their profits so they have stopped further investment in rental housing and the overall effect is negligible from a redistributive viewpoint.

Given the observed high level of mobility among tenants in Ontario, who obtains the benefit of the rent subsidy implicit in the rent-controlled stock? The argument is that sitting tenants get the subsidy and by leaving, they lose the subsidy. Blatt (1982a, p. 39) citing Sternlieb and Hughes (1979, p. 37) states

> The group that is getting the greatest benefit from rent controls is the middle class -- who are probably also the major taxpayers. ...
>
> Rent control represents more than a transfer of resources between landlords and tenants. It is not a two-party transaction but rather a three-party concern; with the third party -- all other property taxpayers within the community -- having to bear the ultimate costs of the rent control subsidy" (Sternlieb and Hughes, 1979, p. 37).

Arnott (1981) offers the following observations about the distributive effects of controls in Ontario:

- controls unambiguously hurt landlords but have an unclear distributional impact;
- spill-over effects from the controlled to the uncontrolled market are also ambiguous;
- new construction, although exempted now, through expectations that controls may be imposed in the future, is adversely affected.

His analysis shows that change in value, not book rate of return, is the best summary measure of landlord welfare.

Capital Losses

Slack and Amborski (1984, pp.34-41) point out that rent control can produce large capital losses for the owners of controlled buildings at the time rent controls are imposed or are made more restrictive (unexpectedly). They note that Smith and Tomlinson (1981) and Blatt (1982a) provide some indication of the size of such losses, but they do not attempt to distribute it by income class.

We emphasize that we should not assume that such capital losses are concentrated exclusively among the highest income households (e.g., over $35,000 in 1984). In Chapter 7, we estimate that one-third of all rental units are owned by "amateur" or "mom and pop" landlords. It may well be that many of these owners of small buildings (individuals, partnerships), perhaps one-fifth of whom are owner-occupiers, have rather modest to average incomes.

Finally, we agree with Slack and Amborski (1984, p.65) who state, "even if it is established that rent review is a progressive policy [i.e., redestributes income in a progressive fashion], one has to consider whether it is the best policy for redistributing income." They continue, "This question is particularly important in light of the previous findings suggesting that the policy may not be horizontally equitable and also that it may be an inefficient means of redistributing income." (p.65). They conclude, as we do, that for a number of reasons (inefficiency, inequity) that the redistribution of income should not be a primary objective of rent regulation. In any event, the distributive effects of rent regulation should not be considered in solution from the host of housing-market related government programs. They too explicitly or implicitly redistribute income on a substantial scale. See, for example, CMHC (1983) re S.56.1 and Andersen (1984).

9.0 TENANT MOBILITY

9.1 Introduction

It is usually argued that rent controls have the effect of reducing the mobility of tenants. For example, Paish writing in 1950 argued that the two principal adverse effects of controls were inadequate maintenance and reduced mobility of labour. He indicated that the latter problem was "probably even more serious than the first". In his view, "rent restriction involves what is in effect a tax on the landlord and a subsidy to the tenant". "But," he continues, "it is a subsidy which the tenant receives only so long as he stays in his existing house" (Paish, 1981, p. 158). This may be overstating the case for the tenant who moves may be able to obtain another rent-controlled unit despite the lower vacancy rate in the controlled sector as opposed to the uncontrolled sector. It would appear, however, that the incentive to "stay put" would be greater in a control system which has a "vacancy decontrol" provision, i.e., when a unit becomes vacant the landlord is able to raise its rent to the market level after which the increase in rent becomes subject to control again.

But other factors are likely to influence the mobility of tenants under rent control. These include:

- the vacancy rate in the controlled and uncontrolled sectors,
- the relative size of the controlled and uncontrolled sectors,
- the provisions in the landlord and tenant legislation regarding periods of notice prior to moving out, the right to sublet, the size of damage or cleaning deposits,
- the age structure of the population,
- the composition of households, i.e., couples with children versus singles,
- the ease of moving from the rental to the ownership market, and
- the size of the rent gap between the controlled and uncontrolled sectors, holding quality of accommodation constant, i.e., the larger the gap, *ceteris paribus*, the lower one would expect the mobility rate to be.

Table 6 - 37

Renter Mobility Rates -- Percentage of Tenants Who Have Moved During the Previous Year

Municipality	1976-77	1977-78	1978-79	1979-80	1980-81	1982-83
Metro Toronto	41 %	33 %	36 %	33 %	29 %	29 %
Hamilton	40	33	37	37	36	N/A
London	55	49	49	49	45	41
Windsor	N/A	N/A	47	44	43	N/A
Ottawa	43	40	40	40	39	N/A
Thunder Bay	44	46	49	47	43	N/A
Sudbury	39	40	41	40	38	N/A
Kingston	N/A	55	N/A	N/A	N/A	N/A
Sault Ste. Marie	N/A	45	N/A	N/A	N/A	N/A

N/A = Not Available; the city was not surveyed at that time.

Source: Ontario Ministry of Municipal Affairs and Housing, Rental Market Surveys, (Toronto: MOMAH, various years).

9.2 Gross Mobility Rates in Ontario

Data on mobility are fairly difficult to obtain but the Ontario Ministry of Municipal Affairs and Housing has made regular surveys of the rental housing market. Table 6-37 reports on surveys of several thousand private rental households in several Ontario cities over the period 1976/77 to 1982/83. (This survey was then discontinued.) Mobility is measured in terms of the percentage of renters who have moved during the previous twelve months. (This will also be referred to as the "turnover rate".)

Several points should be noted. First, mobility rates appear to be quite high -- about 40% of tenants surveyed had not been living in the same unit 12 months earlier. In other words the annual turnover was about 40%. However, this measure does not provide any indication of how long those who had not moved in the past twelve months had been living in their present accommodation. For example, the data in Table 6-38 indicate that for various surveys in the Metro Toronto area between 18% and 64% of tenants have been living in their present unit for more than five years. Table 6-39 indicates that 24.5% of all renter household in Canada in 1971 had been living in their present dwelling for six or more years. In 1981 the comparable figure was 20.5% suggesting a slight increase in tenant mobility.

In one sense the tenant turnover rate in Ontario as measured by the data in Table 6-37 is overstated. Table 6-40 indicates from 6% to 11% of tenants who moved lived in the same city but did not rent at the end of the survey period. In other words they exited from the rental market by, for example, buying a house, living at home or becoming a boarder. On the other hand, these data do not measure "new entrants" to the rental housing market either from outside the jurisdiction or those who have left the ownership market.

Tenant mobility rates in Ontario are somewhat higher than the Canadian average. Data in Table 6-39 indicate that the turnover rate for Canada as a whole was 33% in 1971 and 1981.

Second, mobility rates, as reported in Table 6-35, appear to have declined slightly since rent controls were enacted in Ontario. For example, the fraction of tenants who have moved in the previous year in Metro Toronto decreased from 41% in 1976/77 to 29% in 1980/81 and 1982/83. While a similar decline was found in London, the declines in other cities were not as great. Most analysts argue, as we have noted, that renter mobility will decline under rent control, particularly for those living in controlled units. Cullingworth's (1981, pp. 16-20) review of the literature suggests "the evidence is decidedly thin and certainly not all one way".

9.3 Tenant Mobility: Sample Surveys, Metro Area

A survey of 205 tenants in the Bathurst-Eglinton ward (#11) of the City of Toronto conducted between January and March 1982 revealed the following data on tenants' attachment to their present dwelling and to the district:

years	at present address	in this district
0 - 4	36%	22%
5 - 8	16	16
9 - 12	19	12
13 - 16	11	12
17 - 20	14	15
21+	5	23

It should be noted that the average rent of tenants in Bathurst/Eglinton was slightly higher than the average for Metro, e.g., two-bedroom units were $406 versus $376, but one-bedroom units were $329 versus $321. At the same time, it appears that the average income in Ward 11 was slightly below the Metro average (e.g., 54% under $20,000 versus 47% respectively). In fact, the rent to income ratio of tenants in Ward 11 was noticeably greater than for Metro: 46% had a ratio greater than 25% in Ward 11 versus 31% for Metro as a whole.

While 72% of Ward 11 tenants had lived in their present unit for five or more years, a survey of 293 tenants in Scarborough between November 1983 and

January 1984 found that 25% had lived in the same unit for more than five years. The complete distribution was as follows:

less than 1 year	37%
1 - 2 years	17
2 - 5 years	27
more than 5 years	25

Schwar (1984, p. 6) found that "long term tenants [more than five years in this case] are more likely to be involved in tenants' associations and in the larger community than those who moved more recently. They are also more likely to be aware of existing tenants' rights, and to vote in federal, provincial, and municipal elections". She continues, "small buildings close to transportation and shopping facilities appear to be more conducive to long-term tenancy".

The North York Tenants Information Program (1975) undertook a sample survey of 500 rental units in North York in June 1975. (Some 10% of all non-subsidized apartment buildings were included in the sample.) In terms of length of time in their present unit the survey found the following data (p. 11):

•	0 - months	13%
•	6 - 12 months	16
•	1 - 2 years	23
•	2 - 3 years	13
•	3 - 5 years	18
•	5 - 10 years	12
•	over 10 years	6

In other words, in 1975 only 18% of North York tenants had lived in their unit for five or more years in contrast to 64% of tenants in Bathurst/Eglinton in 1982 and 25% of tenants in Scarborough in 1983. Two-thirds of the North York tenants spent more than 25% of their income on rent and the mean was 35% (p. 13).

9.4 Gross Mobility Rates in U.S. Cities

A survey of tenant mobility rates in a number of American cities is provided in Appendix A to this chapter. To put the Ontario data in perspective we provide the following data on tenant turnover in the U.S.:

Table 6 - 38

Data on Longer-term Tenants in the Toronto CMA

Sample	Percentage of tenants living in the same unit for more than 5 years
• Toronto, 1984, n = 500+ (Knetsch et al., 1984)	31%
• Scarborough, 1984 n = 293 (Schwar, 1984)	25%
• Bathurst/Eglinton, 1982 n = 205 (City of Toronto, 1982)	64% *
• North York, 1975 n = 500 (North York Tenants Information Program, 1975)	18% *

* 5 or more years

Table 6 -39

Renter Households by Length of Occupancy in Present Dwelling, Canada

1961 - 1981, percent

Length of Occupancy	1961	1971	1981
Less than 1 year	31.4	33.2	32.5
1 - 2 years	46.6	25.4	26.6
3 - 5 years		16.9	20.4
6 - 10 years	10.5	12.2	11.3
More than 10 years	11.5	12.3	9.2
	100.0	100.0	100.0

Source: Census of Canada, as cited in Clayton Research (November 1984, Appendix, p. A-19).

• New York City	
- 1981 pre-1947 rent stabilized units	19%
- 1981 post-1947 rent stabilized units	11%
- 1978	17.8%
- 1975	18.5%
- 1973 - 1975	12% p. a.
- 1973	17.3%
• Los Angeles	
- 1974 - 1977	34 - 35% p. a.
- 1978 - 1980 (with controls)	30 - 33% p. a.
• Fifteen Cities (average) without rent control	
- 1970	38%
- 1974	44%
- 1977	43%
• Three Cities (average) with rent control	
- 1970	24%
- 1974	22%
- 1977	24%

9.5 Reasons for Tenant Mobility in Ontario

Some insight into the reasons why renters moved during the previous year are given in Table 6-40. For the four Ontario cities over the period 1977/78 to 1980/81, about one-half of the movers had rented a different unit within the same city.We don't know why these people changed their place of abode, e.g., we don't know if they were evicted for bad behaviour or moved because of a rent increase or because they needed or could afford a larger unit.

About one-fifth of movers had been living in the same city, but were not renting a year prior to the date of the survey. About 30% of movers were living in a different city a year prior to the date of the survey.

In Table 6-41 we provide data on the reasons why tenants moved between October 1980 and October 1981. The most important reason is "location", accounting for about one-third of all responses. It is difficult to know if the move was involuntary, e.g., to keep one's job, or voluntary. "New household formation" accounted for about one-sixth of moves -- the implication is that marriage, divorce or separation leads people to alter their accommodation. "Change in spatial needs" was the next most frequently cited reason for moving.

Table 6 - 40

Reasons Why Renters Moved, Selected Cities in Ontario, 1977-78 to 1980-81

Mover's Previous Situation 12 Months Earlier	Toronto				Ottawa				London				Hamilton			
	1977-78	1978-79	1979-80	1980-81	1977-78	1978-79	1979-80	1980-81	1977-78	1978-79	1979-80	1980-81	1977-78	1978-79	1979-80	1980-81
Rented Different Unit Within Same City	18 %	18 %	16 %	22 %	17 %	22 %	17 %	24 %	24 %	20 %	23 %	30 %	15 %	15 %	17 %	N/A
Lived in Same City But Did Not Rent at End of Survey Period	7	9	7		9	6	7		10	11	8		9	8	7	N/A
Lived in Different City at End of Survey Period	8	9	11	6	15	11	12	12	16	18	18	15	13	14	12	N/A
Total % of Movers	35	36	33	29	40	40	37	46	49	49	49	45	37	37	37	N/A
Sample Size	1,177	745	765	750	1,065	722	611	569	439	845	729	745	1,097	567	611	N/A

N/A = Not Available; city not surveyed at that time.

Source: Ontario Ministry of Municipal Affairs and Housing, Rental Market Surveys, (Toronto: Ontario Queen's Printer, various years).

Table 6-41

Reasons for Moving Between October 1980 and October 1981

Ontario Municipalities

Reason	Metro Toronto	Hamilton	London	Windsor	Ottawa	Thunder Bay	Sudbury
Affordability (%)	10.9	11.8	14.4	11.0	12.6	8.5	10.7
Change in Spatial Needs (%)	17.5	12.4	11.5	16.2	14.7	10.6	12.3
Location (%)	28.4	26.3	40.7	33.4	35.7	38.3	34.7
New Household Formation (%)	14.7	23.2	11.9	14.0	14.7	18.1	18.0
Quality (%)	5.7	12.9	5.4	5.9	9.2	6.4	4.7
Tenure Change in Previous Unit (%)	10.0	7.2	5.8	8.5	3.4	6.0	6.3
Personal (%)	12.8	6.2	10.3	11.0	9.7	12.1	13.3
Total (%)	100	100	100	100	100	100	100
Sample Size	211	194	312	272	238	282	300

Source: Rental Market Survey in Seven Ontario Municipalities -- October 1981 (Toronto: Ministry of Municipal Affairs and Housing, 1982), p. 11.

It may well be related to new household formation. Between 8.5% and 14.4% of the sample moved for reasons of "affordability". This may be attributable either to an increase in rent or to a decline in the household's income, perhaps due to unemployment. Between 4.7% and 12.9% of tenants who moved did so for "quality" reasons. Again we don't know if the quality of building services declined (e.g., failure to make repairs or maintain cleaning standards in common areas), or tenants wanted to upgrade the quality of their rented accommodations. Third, the survey found that from 3.4% and 10.0% of movers experienced a change in tenure in the previous year. But we don't know if, for example, their previous landlord converted his building to condominiums, or those surveyed were not renting a year earlier, i.e., they were homeowners or living with relatives. Finally, it may be that the "personal" reasons column conceals part of what we want to know, for example, eviction, conflict with the landlord resolved by voluntarily moving, or discriminatory behaviour by the previous landlord that forced the tenant out.

Table 6-41 provides some additional insight into the reasons why in 1980/81 about 40% of tenants in Ontario moved. Over 40% of the movers indicated that they moved for "location related" reasons -- presumably to be closer to work, because they moved between cities, or because of proximity to friends, relatives or shopping. Slightly less than one quarter of movers did so for reasons of "affordability", presumably to obtain a lower rent -- perhaps because their icome had fallen (unemployment?) or because rent increases had raised their rent-to-income ratio.

Similarly, slightly less than one-quarter or movers moved because of the "physical properties of the unit." Presumably this includes the "pull" of more attractive characteristics of their present unit (e.g., larger, better view, more amenities, better maintenance) and the "push" characteristics of the previous unit including the general level of maintenance.

9.6 Mobility and Size of Rental Buildings

It has been suggested that tenants living in smaller buildings are "closer" to their landlords, possibly because in smaller buildings a substantial fraction of landlords also live in their buildings. For example, in Metro Toronto in mid-1975 a survey of 94,235 low-rise rental structures (from single family dwellings to 7-plexes) found that in 19,979 the owner lived in his building. Thirty-seven percent of duplex owners occupied the second unit and in 35% of triplexes the owner lived in one of the units. In buildings with four to seven units, in 21% the owner lived in the building with his/her tenants (see Ministry of Treasury..., 1975, p.3).

The rental market surveys by MOMAH between 1977 and 1981 provide data on tenant mobility (the percentage of tenants who moved in the previous year) by size of building. Table 6-42 indicates that in 1977/78 and 1978/79, if we compare the turnover rate between non-apartment structures (i.e., single family houses, duplex, row and townhouse units), and those with six or more units, we find that for the eight cities there were, roughly, an equal number of observations in the three categories: about equal turnover; higher turnover in larger buildings; and lower turnover in larger buildings.

For 1979/80 and 1980/81 we find that tenant turnover was almost always lower in the larger buildings (over 20 units and over 50 units respectively) than in structures with only one or two units. This finding is not consistent with the hypothesis that turnover will be lower in smaller buildings. For example, in Metro Toronto in 1979/80 the turnover rate was 43% for tenants in buildings with one or two units while it was 29% for those in buildings with more than 20 units. In Windsor in 1980/81 the turnover rate was 44% in buildings with one or two units while it was 33% in buildings with more than 50 units.

9.7 Mobility and Rent Increases

Did the movers experience a higher or lower rate of rent increase during the year? The survey for the period 1978/79 found that the median increase for movers and non-movers was not statistically significant with the exception of Toronto. There, movers had a median increase of 7.5% while that for non-movers was 5.8%. However, MOMAH (1980, p. 17) points out that the distributions for three other cities "show substantial differences... and all the differences indicate that mover units are subject to a greater incidence of high percentage rent increase (greater than 10%) than are non-mover units". This information should not be construed to suggest that the cause of a move is a higher than average rent increase. The data do not permit us to determine cause and effect. The data also do not tell us if tenants moved voluntarily or involuntarily in response to some (non-rent) action by a landlord.

While we did not find that tenant turnover is positively related to buildings size -- indeed, there is some evidence to suggest the inverse relationship may hold -- we did find evidence to indicate that non-movers living in smaller buildings (fewer than six units) "got a break" in terms of rent increases as compared with tenants in larger buildings. Table 6-43 indicates that the fraction of tenants in small buildings receiving no increase in rent over the previous year was as high as that for tenants in buildings with six or more units. For example, in Metro Toronto in 1977/78, over 45% of tenants in small buildings did not experience any rent increase a compared with 9% of tenants in larger buildings. In 1980/81 the fractions were 33% and 9% respectively. In London in 1977/78 the fractions were 40% and 20% respectively, and in 1980/81 they were 37% and 11% respectively.

The data in Table 6-43 also indicates that, regardless of the size of the building, a substantial fraction (about one-third) of tenants did not experience an increase in rent when (i) vacancy rates were low or very low, (ii) the

Table 6-42

Percentage of Non-Movers by Building Size, Ontario Cities, 1977-1981

Year Type of Structure	Metro Toronto	Ottawa	Hamilton	Kingston	London	Sault Ste.Marie	Sudbury	Thunder Bay
Oct. 1977-Oct. 1978								
Non-apt. structure**	67.0	64.2	60.0	43.7	51.0	56.7	64.7	49.6
Less than 6 units	64.2	57.1	57.8	48.9	43.1	51.6	55.3	55.8
6 units or more	68.1	58.1	64.7	43.6	54.2	56.7	57.1	56.6
Oct. 1978-Oct. 1979				Windsor				
1 to 2 units**	63.5	62.7	61.3	53.3	52.3	na	60.9	46.3
3 to 5 units	63.9	58.8	61.4	49.2	36.4	na	61.6	51.5
6 units or more	64.6	58.8	64.3	53.2	53.4	na	56.6	55.3
Oct. 1979-Oct. 1980				Windsor				
1 to 2 units**	57.3	58.6	59.1	54.1	50.8	na	64.4	55.3
Less than 6 units	61.5	61.5	58.5	50.0	47.3	na	57.0	46.6
6 to 20 units	61.2	62.8	62.5	63.0	41.9	na	57.1	53.5
More than 20 units	71.1	59.6	65.7	58.7	54.7	na	61.1	56.8
Oct. 1980-Oct. 1981				Windsor				
1 to 2 units**	66.7	60.6	65.6	56.0	57.1	na	60.7	58.6
Less than 6 units	52.9	50.7	55.6	54.2	53.9	na	63.7	48.6
6 to 50 units	68.7	57.8	69.6	51.0	54.0	na	59.0	61.0
More than 50 units	76.0	66.2	62.8	67.5	54.2	na	67.6	60.5

** Non apartment structures, includes all single family duplex, row and townhouse units.

Source: MOMAH, Rental Market Survey (Toronto: MOMAH, various years).

Table 6-43

Percentage of Units with No Rent Increase During the Year by Building Size (Non-Movers), Ontario Cities, 1977-1981

	Metro Toronto	Ottawa	Hamilton	Windsor	London	Thunder Bay	Sudbury
1977-78							
≥ 6 Units	8.8%	11.6%	12.7%	na	20.2%	17.3%	30.1%
< 6 Units	45.5	30.3	48.0	na	40.4	49.6	65.6
1978-79							
≥ 6 Units	11.8	13.1	11.3	15.0	20.8	20.1	45.6
< 6 Units	35.1	31.8	45.3	50.0	52.4	54.6	72.3
1979-80							
≥ 6 Units	11.1	10.6	9.7	24.9	18.8	15.6	24.7
< 6 Units	39.2	40.2	53.8	54.4	42.9	57.1	56.9
1980-81							
≥ 6 Units	9.1	12.8	12.3	37.0	11.3	15.4	10.3
< 6 Units	32.8	28.8	40.8	63.3	36.9	52.9	44.4
1979-80 Sample Size	502	391	385	414	372	389	529

Source: MOMAH, Rental Market Survey (Toronto: MOMAH, various years).

Table 6-44

Rent Increases for Movers and Non-Movers, Ontario Cities, 1978/79 to 1980/81

Municipality		1978 - 79		1979 - 80		1980 - 81	
		median	average	median	average	median	average
Metro Toronto	NM	5.8	4.0	6.0	7.3	6.0	6.6
	M	7.5	16.4	5.8	6.4	6.6	11.5
Ottawa	NM	5.9	6.0	5.8	7.3	5.9	6.5
	M	5.9	5.7	5.7	7.0	6.4	8.6
Hamilton	NM	6.0	7.6	5.8	6.1	6.0	7.3
	M	5.9	5.1	6.2	8.6	10.0	11.7
Kingston	NM	5.5	5.8	na	na	na	na
	M	4.4	6.4	na	na	na	na
London	NM	5.8	6.2	5.8	5.7	5.9	5.6
	M	5.5	6.5	5.9	8.8	6.4	8.2
Sault St. Marie/ Windsor (79/80; 80/81)	NM	5.5	3.8	5.9	6.7	2.8	3.3
	M	6.3	8.7	5.3	6.9	2.2	2.7
Sudbury	NM	0.4	3.3	5.6	6.9	6.0	7.7
	M	6.5	17.6	6.5	9.4	9.6	14.8
Thunder Bay	NM	4.5	2.3	5.6	7.3	5.7	5.0
	M	6.3	10.0	5.5	7.1	6.0	12.8

NM = Non-movers; M = movers in the past 12 months; na = not available

Source: MOMAH, Rental Housing Survey (Toronto: MOMAH, various years).

legally allowable increase without rent review was 6%, and (iii) the general rate of inflation was between 8% and 12%. Why did so many landlords, in the face of rising costs, and a tight rental market not raise rents by at least the "statutory increase" of 6%? Certainly, the market, if the growth in nominal incomes and the vacancy rate are any indication, would bear such increases.

The data in Table 6-42 suggest that while the turnover of tenants in smaller buildings is no lower than it is in larger ones, tenants in small buildings who do not move are rewarded with lower increases in rent. Between 1977 and 1981 a much higher fraction of non-movers in smaller buildings didn't have any increase in their rent as compared with those in larger buildings. It appears that turnover has costs to the landlord that are not reflected in the generally low vacancy rates during this period. For all Ontario CMAs combined, the vacancy rate between 1977 and 1981 never exceeded 2% -- see Table 6-24 above.

Do movers experience higher increases in rent in the year they move? The data in Table 6-44 suggests that, on average, they do. In 16 of the 22 "cells" in the table over the three years for which we have data, the average increase experienced by movers was greater than that of non-movers. In 13 of the 22 cells the average for movers was more than two percentage points greater than in Metro Toronto movers experienced an average rent increase of 16.4% as compared with 4.0% for non-movers. In 1980/81 the comparable figures were 11.5% and 6.6% respectively. Second, in Thunder Bay in 1980/81 non-movers faced rent increases averaging 5.0% versus 12.8% for movers. In Hamilton in the same year the comparable statistics were 7.3% and 11.7%, and (iii) in 1978/79 in Sudbury movers experienced an average increase of 17.6% as compared with only 3.3% for non-movers.

The observed difference in rent increases between movers and non-movers are greater in respect to the average increase than they are with respect to the median increase indicating that the distribution of increases for movers is more greatly skewed toward higher increases than of the distribution for non-movers. In any event, the observed difference in the average rent increases of movers and non-movers may be attributable to differences in quality, that is, movers moved into units that were higher quality than their previous unit. It may have been newer, larger, and contained more amenities. Recall from Table 6-39 that almost one-quarter of movers said they moved because of the "physical properties of the unit".

9.8 Low Vacancy Rates and High Mobility Rates

Absolute tenant mobility rates appear to be high relative to the vacancy rate in the rental housing market, particularly in the controlled sector which accounts for 80% of all rental units in Ontario. With few exceptions, the vacancy rate in Ontario cities since controls were implemented in late 1975 has not been above 3%. How do one-third of all tenants change their place of abode in any year if only 1% to 3% of rental units are vacant at any one time? The figures appear to be contradictory. The explanation may be that there is a large-scale informal market in tenancies that does not show up in CMHC's vacancy surveys or in the newspaper want ads. The Landlord and Tenant Act provides that a landlord must give notice in writing of his intention to increase the rent not less than 90 days prior to the end of the period of tenancy or the term of a tenancy for a fixed period (S.115). Under sections 101 and 102 the landlord or the tenant must give 60 days' notice to terminate a monthly or year to year tenancy. In effect, a tenant has 30 days to search for another unit after he receives notice of a rent increase -- before he must notify the landlord of his intention to vacate. Moreover, landlords can only increase the rent once every 12 months. In other words, at least once a year, most tenants have a 30-day "free hunting period" in which to find a more attractive unit. However, we suggest a casual search for a better deal occurs on a continuous basis. If a tenant finds a better unit and immediately gives notice the maximum "rent penalty" for moving would be two months' rent. This would occur only when a tenant has to take immediate possession but still gives the required 60 days' notice and their original unit remains vacant for the entire notice period. This is unlikely to be the case -- precisely because vacancy rates are so low. Because subletting is both legally easy and because there is excess demand for controlled units, it is likely that a tenant finding a better unit will be "out" no more than one month's rent. If the switcher ends up paying one month's extra rent to find a better place, this is only an 8% premium on his next year's rent. Given that a tenant is unlikely to incur other non-negligible transaction costs (e.g., moving, re-decorating costs) for only a marginal improvement in his unit, the tenant will probably recover the "rent penalty" within one year of moving to a better unit. He will do so because a move will only be undertaken if the new unit offers a substantial improvement over the old one, i.e., it will cover the costs of the rent penalty.

Appendix A

Tenant Mobility in American Cities

New York City

James and Lett (1976, Appendix E) refer to several estimates of tenant turnover in New York. For example, Sternlieb (1972) estimates the annual turnover of rent controlled units between 1963 and 1967 was between 7% (larger post-1939 buildings) to 15% (in larger old-law tenements). In 1973 the Institute of Real Estate Management estimated the turnover rate for buildings with elevators was 17.3%. Data from the 1970 Census of Housing implies that the average length of residence of tenants was 5.7 years, hence the annual turnover rate was 17.6%.

- James and Lett's (1976) own survey of 4,766 units in 41 structures subject to rent stabilization (as opposed to the more stringent rent control) indicated a turnover rate of 18% in 1975. For a smaller sample of nine structures subject with 669 units the average annual turnover rate between 1973 and 1975 was 12%. Their sample of 28 structures with 1997 units, 40% of which were subject to rent control and the rest to rent stabilization indicated that between mid-1971 and the end of 1975 total tenant turnover was 54% or 12% per year (James and Lett, 1976, Appendix F).

- Marcuse (1979, p.33) found that in the 1978 Housing Survey of New York City 429,500 renter households were "recent movers", i.e., had moved into their unit in the previous 15 months. Since there were 1,930,000 occupied rental units in the estimated annual turnover rate was (429,500 ÷ 1,930,000) (12 ÷ 15) or 17.8%. He found that 71.5% of recent movers had moved within the same borough while 15.1% had moved from another borough in New York City, and 13.4% had moved from outside New York City.

- Sternlieb (1976, p.89) provides mobility data for New York based on the 1975 Housing and Vacancy Survey. He found 21.6% of renters had moved in the previous 14 or 15 months compared with 23.7% in the year prior to the 1968 survey. The comparable turnover rate in 1975 survey for renters receiving public assistance was 26.5%. On an annual basis, therefore, the turnover rate for private-sector renters in 1975 was about 18.5% which is very close to the rate in the 1978 Survey. The 1975 Survey found that 34.3% of all renters had lived in their unit for at least 9 years and that 16.3% had been in their present unit for at least 16 years (Sternlieb and Hughes, 1976, p.188).

- Stegman (1982, p. 126) provides only very limited data on tenant mobility based on the 1981 Survey. He found that while 22% of all renters surveyed in 1981 moved into their pre-1947 rent stabilized unit in either 1980 or 1981, the comparable rate for the post-1947 stock was just 13%. [Note that rent stabilized units amounted to 928,000 units out of 1,214,000 units under some form of rent regulation.] Because the Survey was conducted in February and March 1981 these data imply annual turnover rates of about 19% and 11% respectively. Stegman (1982, p. 153) also found that nearly 40 percent of all tenants with incomes under $6500 living in "controlled" units (which account for 23% of the city's rental stock) have not moved since 1953 or earlier, indicating a tenancy of at least 28 years. Even for those with incomes above $12,500 (the average for all tenants was $11,000) the almost 20% of tenants in controlled units had lived in their units for more than 28 years. The fraction of tenants in these units who had lived in their apartment for at least 22 years was 49.3% for those with incomes under $6,500. 42.8% for incomes between $6,500 and $12,499; 30.5% for incomes between $12,500 and $24,999 and 36.2% for those over $25,000.

Los Angeles

Rydell et al. (1981, p. 26) provide the following estimates of mobility rates for Los Angeles between 1974 and 1980:

Year	All Households	Renter Household
	Number of Moves During Previous 12 Months as a Percentage of Households	Percentage of Households that Moved in Past 12 Months
1974	41.7%	34.9%
1975	41.7%	34.8%
1976	41.2%	34.4%
1977	42.0%	34.9%
1978	39.0%	32.5%
1979	36.5%	30.4%
1980	33.5%	30.2%

These data are obviously much closer to those in Ontario cities, notably Toronto. For example Metro Toronto's mobility rate fell from 41% in 1976/77 to 33% to 36% between 1977/78 and 1979/80; then it fell to 29% in 1980/81 and 1982/83. The comparable rate for Los Angeles was between 30% and 35% between 1974 and 1980 (this measure being based on both annual housing surveys and the number of new electric accounts). Rent control began in Los Angeles in 1978.

Rydell et al. (1981, p. 27) note that the mobility of all households (owners account for 43.4% of all housing units) declined by more than eight percentage points between 1977 and 1980. They suggest that "Proposition 13 may have contributed to the general decrease in mobility because of the property tax advantage it gave nonmobile homeowners) (as they are not reassessed).

Rydell et al. (1981, p. 29) provides data for Los Angeles that shows the large difference in turnover/mobility rates between ownership and renter units. In 1974 it was 35% for renters and 8% for owner units. For 1977 the comparable figures were 35% and 9%.

Other U.S. Cities

Rydell et al. (1981, p. 28) provide data on renter mobility for 15 U.S. cities that did not have rent controls. The cities included Detroit, Pittsburgh, Dallas, Memphis, Albany, and Spokane. The fraction of tenants who had moved during the previous 12 months was as follows:

	Average	Range
1970	38%	23 - 46%
1974	44%	25 - 55%
1977	43%	24 - 53%

Rydell et al. (1981, p. 28) provide the following renter mobility data for three cities (Washington, D.C., Boston, Newark) in which rent controls were in effect:

	Average	Range
1970	24%	22 - 25%
1974	22%	18 - 26%
1977	24%	20 - 30%

It appears, therefore, that renter mobility increased in the early 1970s in cities without rent control and decreased very slightly in the case of cities where controls were in place. More important is the large difference in the level of renter mobility between controlled and uncontrolled cities -- even when we note the small size of the "sample".

Chapter 7

CONCLUSIONS FOR PUBLIC POLICY

1.0 INTRODUCTION

In this study we have presented three analytic frameworks to examine the links between design characteristics and the effects of rent regulation -- see Chapter 4. We have also reviewed some of the evidence on the effects of rent control in Ontario and other jurisdictions -- see Chapters 3 and 6. We have presented the reader with contingent statements joining the academic crowd of "two-handed scientists", that is, scientists who instead of providing conclusive advice, keep reiterating, 'on the one hand', ..., 'but on the other'. In this chapter we shall attempt to present our final conclusions (on the balance of probabilities) without the comfort of too many qualifications.

We must emphasize that rent regulation is only one of many government policies aimed at providing rental accommodation at a fair or "affordable" level of rent -- see Chant (1985). The effectiveness of rent regulation is determined in part by the characteristics of these other policies. In turn, the impact of rent regulation and these other policies depends on a variety of macro-economic and demographic variables. In other words, the effects of a system of rent regulation is influenced by myriad other policies which governments initiate to achieve a variety of objectives. Some are directly relevant and positively associated with the objectives of rent regulation. Others are only indirectly (and sometimes negatively) related to rent regulation. The design of a system of rent regulation must therefore consider not only its own characteristics, but also the effects of the interaction of these characteristics with other policies and programs. Indeed, policymakers must consider whether certain policy objectives (e.g., affordable housing) can more effectively be achieved by policies other than rent regulation -- see Slack and Amborski (1984) and Marks (1984c).

The choice of the characteristics of a system of rent review will also depend on the priority one places on different objectives, and the costs one is willing to incur to achieve these objectives. Priorities with respect to the management of the rental housing market depend to a large extent on the demographic and economic scenarios that are forecasted. The Commission of Inquiry has also studied these important areas, i.e., other government policies related to rental housing, selected macro-economic and demographic projections and the determinants of future housing supply. Therefore, in this study we have focused upon developing an understanding of the relationship between design characteristics and effects, given alternative contingencies (e.g., excess demand resulting from a demographic change, inflation). Thus, our conclusions drawn in this chapter narrow the set of options to modify the system of rent regulation in Ontario, but we do not attempt to identify an optimal choice.

We have avoided the temptation of entering the debate on whether rent regulation in general is beneficial or deleterious. Nevertheless, we have reviewed the experiences of many other jurisdictions. That experience is important in providing the means for identifying the major effects of rent control. A broad comparison of the effects of rent control in many jurisdictions in different periods creates a "randomization effect", thus isolating only the very general effects of rent control. Indeed, only the most robust and large effects are likely to be identified. This is not satisfactory for policy formulation where the question needing to be answered is not what effects can be attributed to rent control operating in isolation in any environment, but rather how rent control is going to affect a particular system (Ontario in our case). It is necessary to assess the interaction of a given or proposed policy and the specific social, economic and institutional infrastructure in which it functions. It is also necessary to relate the policy to broader socio-economic policies that have evolved over time in a particular jurisdiction.

We have reviewed in depth the literature concerning rent controls in a variety of jurisdictions and sum up the major findings that emerged in Chapters 2, 3, and 4. These insights are important in constraining the number of design options by eliminating those which appear to be universally deleterious. These insights, however, are not sufficiently conclusive to offer much guidance to policy makers considering changing the design characteristics of a particular system of rent control such as tht in Ontario.

Therefore we have analyzed extensively the evidence on design characteristics (Chapter 5) and effects (Chapter 6) of rent controls in Ontario over the past decade. Our analysis was guided by and benefited from our assessment of the experience in other jurisidctions in pointing out what is general to all rent control systems and what is specific to Ontario. We are therefore able to derive in our conclusions both some general constraints which all rent regulation programs must meet in order to avoid atrophication of the rental housing market, and some specific suggestions which are relevant only to the system as it has evolved in Ontario.

2.0 BASIC VIEWPOINTS

The analysis of rent controls is based in part on value assumptions and in part on technical relationships, that is, relationships between alternative forms of intervention and their anticipated consequences. The analysis of technical relationships, however, involves an element of uncertainty, as we possess imperfect knowledge. The social sciences are imprecise sciences, and our conclusions are necessarily contingent on future uncertain events outside the rental market.

We have identified three basic viewpoints on the public policy concerning the rental housing market. One extreme approach considers the supply and allocation of housing as a matter that should be determined solely by public policy on the basis of politico/administrative criteria. [See the papers in Hartman (1983), Atlas and Dreier (1980), Dreier (1982), Dreier et al. (1980).] The existence of private ownership in this market may be considered as a temporary convenience or a nuisance, depending on the particular point of view of the proponent. Thus, controls should be designed to ensure that the allocation of the existing privately-owned stock is done in accordance with "public interest objectives", with little regard to the long-term survival of private ownership and investment. Indeed, in this view, controls may be regarded as a form of gradual nationalization. The logical consequence of this point of view is the establishment of a comprehensive public housing program of the type initiated by several labour governments in Britain and administered by the local authorities (e.g., Council houses). The advantages of this approach are said to be its effective targeting of the benefits, and the political control over the process. The major disadvantage is high and visible costs to the government and high transaction and management costs for all parties involved.

At the other extreme, there are those who believe that markets are both just and efficient in allocating resources in the economy. (Indeed, if the initial distribution of wealth is not "just", one can redistribute wealth directly, albeit in a visible way, but leave the allocation process to the market.) The role of the public sector, therefore, should be limited only to the protection and enhancement of markets so that they closely approximate perfectly competitive ones. This position allows for some remedial measures of intervention when markets are subject to market failures (see Stanbury, 1985b) or sharp discontinuities, but such measures must not only be temporary but also must be perceived to be temporary. (Some economists would argue that the costs of any public intervention, even temporary ones, will always outweigh their benefits. They claim that the market process is resilient enough to handle most types of disequilibria.)

The third basic approach considers the rental housing market as one that chronically suffers from "market failures" of different types and therefore requires remedies which simulate an efficient "market mechanism" (see, for example, Hulchanski, 1984). This approach places some value on voluntary, private ownership and investment and free choice for tenants, but recommends a permanent, administered pricing system. The ideal appears to be a rent-setting mechanism that succeeds in simulating the market in long-term equilibrium. The essential difference between the second and third approaches is one of greater trust in the ability or intention of regulators, and one of less trust in the desired pattern of allocation in the market.

We have not considered the first approach in any detail in this study since many government policies focused on housing has been studied separately by the Commission of Inquiry -- see Chant (1985). We note that while the first approach is logically consistent, we find that it is inconsistent with society's general policy concerning property rights. We find little reason to view landlords differently from other owners of capital assets. Thus, if it is deemed to be in the public interest to eliminate market mechanisms in allocating rental housing, it should be done directly with appropriate compensation to the owners of rental buildings. In our view, indirect, gradual means of expropriation without compensation are not acceptable in a market-oriented society where property rights are to be respected.

Thus our attention in this paper is focused on the two remaining broad approaches. Here, we found the evidence supports neither of the basic positions. Following sharp discontinuities, the housing market, except with respect to price, appears to adjust to equilibrium at a slower pace than is deemed to be socially acceptable. However, experience with rent regulation suggests that any attempt to manage the adjustment process in a restrictive way brings about a number of undesirable consequences.

The design of a system of rent regulation is intended to fulfill certain objectives. Therefore, we first state the major objectives used to justify rent regulation in Ontario in terms of the specific effects and then we compare them with the actual effects of over a decade of controls.

To draw more general conclusions with regard to the future consequences of rent controls we must relate our observations in Chapters 5 and 6 to the experience of other jurisdictions. The key concept which emerged in the literature of the past decade has been the distinction between "restrictive" versus "moderate" controls. We therefore pose the question: does the evidence in Ontario support the observation that rent controls are "restrictive" or does it support the proposition that rent controls in Ontario have been "moderate"?

To determine whether Ontario's controls have been "moderate" or "restrictive" we employ theory (Chapter 4) and our examination of the Ontario market and past effects of rent controls (Chapter 6). The answer to this question provides us with a strategic recommendation for a broad policy posture. We then proceed to determine what are the impacts of specific characteristics of rent controls. We provide a brief analysis of the impact of different characteristics on different segments of the market and provide a crude estimate of the significance of these segments. We conclude that while a prerequisite of a moderate system of rent control is the gradual closure of the gap between the equilibrium and controlled levels of rent, the specific characteristics and the method of their implementation does matter. We therefore examine some alternative means of achieving this objective. The chapter ends with our principal conclusions.

3.0 RELATING EFFECTS TO OBJECTIVES

Policy makers, when viewing the results of a major public program of a decade's duration, are likely to have a strong interest in the relationship between its objectives and its effects. The objectives cited in this section are those derived from Stanbury's (1984a) analysis of the normative bases of rent regulation in Ontario prepared for Phase I of the Commission of Inquiry into Residential Tenancies and his cross-examination. We now "translate" the stated objectives of rent regulation into desired effects.

3.1 Objectives for the Ontario System

Objective 1: to prevent "gouging" or "unconscionable" increases in rent in disequilibrium situations.

Desired Effects:

- To have increases in each household's rent not exceed the increase in an index of the landlord's costs (e.g., taxes, maintenance, interest rates where the mortgage is renegotiated, major repairs).
- To prevent the household's rent-to-income ratio from increasing on the assumption that income moves reasonably closely with economy-wide average.
- To ensure that landlords do not receive excess profits or windfall gains during periods of excess demand in the rental housing market.

Objective 2: to maintain or increase the supply of "affordable" rental housing.

Desired Effects:

- To decrease the fraction of tenant households with low to moderate incomes who have to spend more than 25 to 30% of their gross income on rent to obtain "decent" housing.
- To increase the supply of subsidized housing (whether privately or publicly owned) available to low and moderate income households. (Note -- this could be an indirect result of controls if goverments responded to the decline in private, unsubsidized supply usually associated with controls by increasing

subsidies to private owners (or tenants) or by directly supplying more publicly-owned housing.)

Objective 3: to provide security of tenure for tenants. There are several possible meanings: (i) economic security of tenure; (ii) legislation that is a necessary complement to controls, i.e., to prevent "dissipation" of the stock of rent-controlled units; and (iii) the set of rules under which tenants may continue to occupy a rental dwelling and those which relate to the renewal of leases. A fourth effect is to prevent the use of a landlords' economic power to evict the tenant: in this context the object is to create a balance between the legitimate interests of landlords and tenants.

Desired Effects:

- To ensure that rents are held down so that each household's rent-to-income ratio does not exceed the customary level.
- To prevent "erosion" of the stock of controlled rental units through conversion, demolition or other forms of removal.
- To increase the legal rights (power) of tenants vis-a-vis those of landlords regarding deposits, prompt payment of rent, renewal of leases and bases of eviction during the period of a lease (e.g., noise, damage, etc.).

Objective 4: to remedy certain problems in rental housing markets said to be market failures. The most important imperfections are the high transaction costs and the imperfect information that characterize the market. Stanbury (1984a) has shown that some advocates of rent control use the argument of "market failure" although in fact they were merely preoccupied with Objective 2 that is, ensuring an adequate supply of "decent, affordable" rental housing for households with low to moderate income.

Desired Effects:

- To provide information to tenants about available rental units, their attributes and their "market price" (i.e., rents for comparative units).

- To provide reliable information to landlords and developers about present and future market conditions.
- To reduce discrimination and "non-economic" barriers to market transactions.
- To reduce risks, transaction costs and lead times in market transactions and investments in rental property.

Objective 5: to smooth for tenants the path of adjustment of rents in disequilibrium situations (excess demand) so as to reduce the economic costs of adjustment.

Desired Effects:

- To ensure that rents (particularly for low to moderate income households) do not rise any more rapidly than increases in household income, the consumer price index or landlords' costs. Where, however, the CPI and landlords' costs are rising rapidly relative to the experience of the past couple of years, the rate of increase in rents should be held substantially below them. Similarly, where the rate of increase in nominal income declines, the rate of increase in rents should be held down so that the ratio of rent to income does not increase appreciably.
- To ensure that the full effect on tenants of the new, higher equilibrium level of rents is delayed as long as possible.
- To shift the burden of the new, higher equilibrium level of rents from tenants to someone else, e.g., landlords, government, etc.

Objective 6: to maintain a mix of types of housing, types of tenure and distribution of households by income level in order to obtain diversity and balance of residents and economic activity in the central area of major urban centres, notably Toronto.

Desired Effects:

- To "freeze" the composition of the central area of Toronto in terms of types of economic activity (commercial, industrial, residential), types of housing (ownership, condo, rental), physical characteristics of housing (high-rise, townhouses, SFD) and, particularly the income mix of residents so that low and moderate income households are able to afford to live in the central area. Therefore, if rents are held below the market clearing level, and the conversion, demolition, etc. of the existing rental stock is tightly controlled, housing will continue to be affordable for lower and moderate income households.

3.2 Success in Achieving Objectives

Did Ontario's system of rent regulation achieve these six objectives? Our analysis indicates that the system has generally prevented "gouging" (Objective 1), although as Stanbury (1985a, Ch. 2) points out, the term has several meanings. Average rent increases in the controlled sector were held significantly below rent increases in the uncontrolled sector and for most of the decade they were held significantly below the rates of changes in the Consumer Price Index or the rental housing price index. The number of landlords with documented financial losses was significant -- see Table 5-3.

The data cited in Chapter 6 indicate that rent controls for a great many tenants have placed a "cap" on the annual percentage increase in rents. Landlords can legally increase rents by more than the statutory rate (8% July 1975 to October 1977 and 6% per annum thereafter) if they are able to justify such an increase in terms of increased operating costs, increased financing payments, approved capital expenditures, financial loss or relief of hardship. While no more than 15% of all controlled rental units have obtained orders for rent increases under rent review in any year between 1976 and 1983/84, the rate of increase allowed has generally been several points above the overall rate of inflation (CPI) as these data indicate:

Year	Increase granted	CPI	Year	Increase granted	CPI
1976	12.6%	7.5%	1980/81	11.6%	10.2%
1977	12.5	8.0	1981/82	14.7	12.5
1978	9.7	8.8	1982/83	14.2	10.8
1979	11.3	9.2	1983/84	10.6	5.8

Table 7 - 1

Measures of the Distribution of Rent Increases Granted Under Rent Review in Ontario, 1976 - 1983/84

Year	Average increase granted	Awards below 6%*	Awards above 25%*	No. of units granted increases	No. of hearings
1983/84	10.6%	13.0%***	2.1% **	106,472	2,742
1982/83	14.2	2.2	21.4	127,812	4,202
1981/82	14.7	2.1	21.7	82,650	2,751
1980/81	11.5	6.4	14.9	42,377	1,438
1979/80	10.7	6.9	11.1	19,469	613
1979	11.3	10.1	4.7	18,370	1,428
1978	9.7	15.3	1.2	40,949	2,808
1977	12.5	(<8%) 9.0	3.7	39,219	3,541
1976	12.6	(<8%) 14.2	2.7	131,455	7,317

* based on number of units in 1983/84 and 1976 through 1979; based on number of hearings in the other years.

** 7.9 % in terms of the number of hearings.

*** 8.1% in terms of the number of hearings.

Source: Derived from the Annual Reports of the Residential Tenancy Commission and Ontario Rent Review Office (Toronto: various years).

While rent review appears to have reduced the average rate of increase of rents in the controlled sector, some tenants experienced much larger increases. Table 7-1 indicates that between 1976 and 1979 from 1.2% to 4.7% of tenants whose units went to rent review had to contend with an increase of more than 25%. This was between two and two-and-a-half times the average increase. Between 1979/80 and 1983/84 from 7.9% to 21.7% of whole building reviews (rather than units) resulted in increases greater than 25%. Given the larger number of units going to rent review in the past few years, this means that in absolute terms a considerable number of tenants have had to endure large increases in rent -- despite the existence of an elaborate system of rent controls in Ontario.

The rates of increase in population and household formation in Ontario declined significantly from the high levels reached in 1974 and 1975. Thus if the housing "crisis" was the result of both (i) overly restrictive rent controls which yielded average returns on equity after interest payments below those which could be obtained by risk-free investments even when tax benefits are taken into account, and (ii) adverse developments in the macro economy and demographics -- see subsection 6.4 in Chapter 6.

Data on the nominal and real rents in Metro Toronto suggest that landlords have not been able to reap excess profits or windfall gains despite the fact that vacancy rates have been at 1% or less between 1980 and 1984. It is not clear, however, that rent controls have achieved their objective of eliminating all excess profits or windfall gains from the ownership of rent- controlled buildings, although Smith and Tomlinson (1981) provide data indicating that in real terms the market price of rental buildings fell in Metro Toronto between 1975 and 1980. There are several problems here. First, we don't have any data that measures changes in landlords' rates of return on equity since controls were imposed. Second, changes in interest rates, where the long-term debt on a building is at a fixed interest rate, can cause a change in the market value of a building, ceteris paribus. Interest rates have fluctuated a great deal between 1975 and 1984 -- see Table 6-22. Third, we don't know if landlords prior to the 1982 Interim Act were able to obtain windfall gains by selling and/or refinancing rental buildings. The 1982 Interim Act was passed in response to the Cadillac Fairway/Greymac/Kilderkin Investments transaction (see Corcoran and Reid, 1984).

The behaviour of a household's rent-to-income ratio over time depends on annual increases in both income and rent. Changes in income have nothing to do with rent control. Rather, they are influenced by macro-economic variables, e.g., the unemployment rate, and the growth in demand. The comparison is complicated by the fact we have no single, comprehensive series on rent levels in Ontario. In Table 6-3 we provide four measures of which the preferred one is the rate of increase in the rent of one-bedroom apartments in the Toronto CMA. Unfortunately, it includes units in both the controlled and uncontrolled sectors. Table 6-1 indicated that with the exception of one year, the annual increase in per capita income in Ontario was several points above the increase in rents. Therefore, we conclude that the average rent-to-income ratio declined over the past decade. (In any event, as we show in Chapter 6, the average rent-to-income ratio in Ontario appears to be below that in other jurisdictions -- New York, for example.)

Rent controls have thus contributed somewhat to maintaining and increasing affordability by keeping average rent increases below the average wage increases (Objective 2), but it is possible that rent increases would have been below wage increases even in the absence of controls. However, we have cited some studies (in Chapter 6) which suggest that the main beneficiaries of rent controls were renters who would be able to enjoy affordable housing in any case. Indeed, some of the "costs" of controls were incurred by new entrants to the rental housing markets (often young singles with lower incomes or elderly moving from the homeownership sector) who had to find housing in the uncontrolled sector. The "mobile", "uninformed" and the new entrants have been more vulnerable to "black markets" and find it more difficult in some cases to utilize the regulatory machinery because of high transaction costs.

The changes in the Landlord and Tenant Act in Ontario have provided security to tenants from arbitrary demands of landlords (Objective 3). We note that an important set of amendments were made in 1970 -- five years before rent controls. These provisions alone, however, did not (and in our opinion could not) protect the economic security of tenure. Subsequently introduced rent controls increased the predictability of the size of rent increases and smoothed the path of change. Therefore, lack of economic security of tenure is now largely a matter of inadequate income, not a problem of rent levels. Conversion activities in Ontario have been severely restricted (see Chapter 6), thus the stock of rental units was adequately protected (at least in the short-run).

Rent regulation has done little to assure that there is an adequate supply of "decent, affordable" rental housing for those with low to moderate income (Objective 4). Since rent controls have been in effect in Ontario, the supply of new rental units has decreased, as the following data on average annual rental starts indicates:

1969 - 1974	37,641 units
1975 - 1979	14,259
1980 - 1984	14,491

(We include 1975 in the first "post control" period because controls were rumoured early in 1975 and announced by the Premier on July 30th.) We note that new rental starts fell at a time that vacancy rates were also falling. Between 1980 and 1984 most Ontario CMAs were experiencing vacancy rates of less than 1% -- see Table 6-24.

Several other points should be noted. First, most advocates of controls recognize that they cannot increase the supply of affordable rental housing. At best they may be able to prevent a reduction in the number of such units -- see Hulchanski (1984). Second, because of tight rental markets, there is a strong incentive to upgrade units -- but this effectively removes them from the stock of "affordable" rental units. Third, while the nominal rents on "affordable" units may be held down by controls, the quality of the units may be reduced due to a decline in maintenance. Fourth, there is something of a paradox where controls have the effect (as they have in Ontario -- see Chapter 6) of increasing the supply of social housing rental units. It is that a higher fraction of households in social housing occupy newer (and affordable) rental units than do households who obtain their housing from the private market.

While controls have definitely pushed up the costs and the risks associated with supplying new rental units, the significant decline in new construction of rental units since controls were introduced cannot be attributed primarily to their introduction. There was at the same time a demographic shift (i.e., a significantly lower level of increase in population) which adversely affected the supply of new rental housing. In addition, there was a shift in demand, increasing the relative price of ownership units versus rentals. This shift started before controls were enacted -- see section 6.0 in Chapter 6.

Prior to 1975 government-assisted rental starts were outnumbered by privatly initiated rental starts by about two to one. Since rent controls were imposed, the reverse has been the case. MOMAH (1983) indicates that the vast majority (about 75%) of new rental starts in the past decade or so have been government-assisted. Moreover, by 1981 some 14% of Ontario's rental stock consisted of socially- assisted housing. The growth is illustrated by the Ontario Housing Corporation which in 1972 had 54,097 rent-geared-to-income units under management and a decade later had 115,524 units. Also in 1982 there were 40,581 private or municipal non-profit housing units in Ontario. Indeed our analysis indicates that new supplies of all types of rental housing in the past decade in Ontario were determined to a large extent by public funding.

Rent controls did little in offering directly services to reduce transaction costs by providing information about the market. Controls have reduced competition in the market by providing higher incentives for tenants and landlords to organize.

Rents in the controlled sector have increased at a lower rate than inflation and the rates of change in the uncontrolled sector (Objective 5). The consequences for the long run, however, are less clear and will depend on government action in funding "public housing". Fallis and Smith (1985a, 1985b) and Jazairi (1983) provide evidence to indicate that as of late 1982 the rents in the controlled sector were about 10% below the market clearing equilibrium level in Toronto and that rents in the uncontrolled sector were about 10% above the equilibrium level. In other words, rent controls have held rent levels below what they would have been in their absence.

We were not able to discern whether rent controls have been able to maintain the mix of types of housing, types of tenure and distribution of households by income level in order to obtain diversity and balance of residents and economic activity in the central area of major urban areas, notably Toronto (Objective 6). There are three problems. First, it is difficult to put this objective of rent control into measurable terms. Second, we could find no data that might help us answer the question. Third, even with such data, it would be impossible to disentangle the effects of rent controls on the housing mix from other variables.

On balance, it appears that Ontario's rent controls have largely achieved objectives 1 and 5 and contributed somewhat to objectives 2, 3 and 4, but with haphazard targetting. Thus controls were not an effective means for achieving these latter objectives. The major question is at what costs these outcomes were obtained and what costs and benefits one may expect from such controls in the future. To provide a partial answer to this question, one must relate the control system in Ontario to rent control systems in other jurisdictions and experiences there. In the existing literature on rent control, design and evaluation revolves around the dichotomy of "restrictive" versus "moderate" rent controls.

4.0 MODERATE VERSUS RESTRICTIVE RENT CONTROLS

Following Blumberg et al. (1974) and Gilderbloom (1980) it has become conventional in the U.S. literature on rent control to distinguish between first and second generation controls and between "restrictive" and "moderate" controls. First generation rent controls are those described as operative in the period from World War I to 1970 while second generation rent controls are said to date from 1971 when President Nixon used the Economic Stabilization Act of 1970 to invoke a 90-day freeze on all wages, prices and rents. Phase II lasted 13 months and established controls over rent increases. In January 1973, Phase III moved to voluntary restraints while Phase IV was to involve decontrol. However, many local jurisdictions had moved to enact controls during federal stabilization efforts.

Gilderbloom and Appelbaum (1984) distinguish carefully between (a) restrictive rent control regimes where rents are set without regard to the landlord's return on investment (in the extreme case, rents are frozen in nominal terms); and (b) "moderate" rent controls in which the intent is to "balance" the interests of landlords and tenants. Moderate controls are said to have the following characteristics:

- Excessive rent increases are prevented while allowing landlords to earn a "fair and reasonable" return;
- New construction is exempt;
- Adequate maintenance is required for landlords to obtain the allowable increases;

- Annual rent increases to cover increases in operating costs are "guaranteed";
- Landlords are allowed to pass through major capital expendiutres (on an amortized basis);
- Landlords may obtain "hardship" increases, e.g., where their cash flow is negative or they are failing to earn a "fair and reasonable" return;
- In some cases, vacancy decontrol is permitted; and
- Controls are equitably administered by an elected board.

Gilderbloom and Appelbaum (1984) argue that moderate controls have the following effects:

- They prevent excessive increases ("gouging") in the form of average increases and as applied to individuals, i.e., they prevent interpersonal discrimination.
- They do not, however, solve the general problem of the affordability of rental housing.
- They do not have an adverse effect on new construction or the quality of the existing stock due to inadequate maintenance.
- There is no decline in the local government's tax base.
- They "guarantee" the landlord a "fair return'.
- They apparently reduce the variance in rent increases.

Why should moderate controls, as Gilderbloom and Appelbaum (1984, p. 15) suggest, have little or no effect one way or the other on the overall housing market in the communities they are in effect? Because research shows that the general level of allowed increases in rent-controlled cities were virtually the same as in non-controlled jurisdictions. They do, however, reduce extreme fluctuations.

Second generation or moderate rent controls "attempt to moderate rent [increases] in the private housing market where tenants are in a disadvantageous bargaining position relative to landlords over rents and maintenance of the premises" (Gupta and Rea, 1984, p. 397). However, as Gupta and Rea (1984, p. 395) note, "there is a tremendous diversity among ordinances of the second generation". Some are far more restrictive than others. For example, a less restrictive system of rent regulation might have the following characteristics:

- vacancy decontrol (i.e., when the unit becomes vacant the landlord can raise the rent to what the market will bear but then subsequent increases are subject to control);
- no rollback or rents to a date before controls were announced;
- rent increases pegged to a fixed annual percentage rather than determined annually by a regulatory body;
- no regulation over demolition or conversion of rental units to other purposes; and
- no special security of tenure regulations to curtail eviction.

With a random sample of 100 landlords in San Diego, Gupta and Rea (1984, p. 402) used discriminant analysis to identify what landlords perceived to be the most important characteristics of a "restrictive" versus a "moderate" system of second-generation controls. In order, the most important variables were the method of determining rent increases; the presence or absence of vacancy decontrol; presence or absence of rent rollbacks; the presence or absence of controls over conversion to condominiums; and the presence or absence of eviction regulations. This discriminant model was then applied to ten California municipalities having rent control ordinances as of January 1982. Two jurisdictions (Santa Monica and Berkeley) were found to have restrictive rent control systems, while the other eight were found to have "moderate" systems. Five of these, including Los Angeles City and County, had essentially the same score on Gupta and Rea's (1984, p. 405) scale.

4.1 Restrictive Controls

Restrictive rent control systems put a virtual freeze on rents, prohibit landlords from passing through increases in costs and provide no guarantee of a "fair return" on the landlord's investment. There is a consensus among students of rent control that in an inflationary environment restrictive rent controls lead to:

- a rapid decline in new construction;
- a significant decline in the supply of rental housing services;
- a gradual decline in maintenance and repairs;
- a shorter economic life for rental buildings; and
- significant increases in conversion and demolition, if permitted.

Some students of rent controls argue that even short-term, moderate rent controls lead to rapid decline in construction and a reduction in the size of the controlled rental housing stock and the flow of services it provides. Gilderbloom (1983c, p. 137) notes that

> recent studies of moderate rent control have reached largely negative conclusions regarding its effects. Out of ten reports written on the subject, only one has argued that moderate rent control has no adverse effects on maintenance, construction or taxes ... and this study suffers from numerous methodological problems. The other reports purport to show that moderate rent control has had the same consequences as the previous, more restrictive rent control programs.

These reports, however, also proved to be faulty and/or biased (Gilderbloom, 1980, 1981a; Achtenberg, 1975).

4.2 Effects of Controls

The major problem facing analysts trying to assess the impact of rent control is the confounding effects of macro-economic, demographic and social variables, as well as the effects of social policies in other domains. For example, if fairly restrictive rent controls are imposed but then the jurisdiction experiences a decline in per capita incomes, and a sharp drop in the rate of new household formation, with almost no increase in landlords' operating costs, and a large increase in subsidies and tax expenditures for rental housing, then controls would have little adverse impact on the rental housing market. Why? Because there would be only a small gap between R_c and R_e. Indeed, it is possible that controls would not "bind", i.e., actually restrain the rate of increase in rents. Conversely, a moderate system of controls could result in large distortions in the rental housing market if there was a sudden, large and persistent increase in demand, together with the removal of government subsidies to aid the construction of new rental units. In short, the economic effects of rent controls depend not only on the design characteristics of the system of controls, but also on macro-economic conditions (notably the rate of growth of real household income), the rate of new household formation, and changes in the level of government financial assistance for new construction of rental units. In general terms, however, we can say that rent controls reduce the speed of adjustment by tenants, landlords and investors to changing economic conditions.

Gilderbloom and Appelbaum (1984, pp. 5-6), upon reviewing the evidence, conclude:

> All of the reliable evidence collected so far suggests that moderate rent controls have not caused a decline in the conditions and size of the rental housing stock. Studies that have argued the opposite thesis are subject to a wide variety of methodlogical flaws which render their conclusions doubtful. These flaws include:
> (1) data provided by landlords (who have a vested stake in the outcome of the study) which is not subject to independent verification;
> (2) small sample sizes for surveys, with not adequate attempt to control for bias in non-response;
> (3) failure to compare rent controlled and non-rent controlled places;
> (4) failure to statistically control for other influences whose effects may be confounded with those of rent control;
> (5) outright falsification of results or conclusions; and
> (6) failure to make distinctions about the kind of rental control enacted.

> ... Studies that have avoided the above problems have found no evidence of negative relationship between moderate controls and the quality and quantity of the housing stock.

Finding no evidence of a relationship between moderate controls and such possible outcomes as the level of maintenance, supply of new units and the local tax base, however, does not mean that the relationship does not exist. Furthermore, in defining moderate controls (as opposed to restrictive controls) in terms of those that are responsive to landlords' concerns about cost increases and a fair return on investments, the results are somewhat tautological. Indeed, "moderation" has meant merely an insignificant impact upon rates of return to landlords. Gilderbloom and Appelbaum (1984, p. 6) observe that:

> in attempting to avoid problems traditionally associated with restrictive controls, moderate controls also may fail to provide across-the-board general rent relief for tenants, rather working [sic] mostly to control extreme or erratic rent increases. In other words, moderate rent controls may often provide protection against rent gouging but will not affect those tenants whose landlords are earning a fair and reasonable return on investment.

The evidence for this proposition is clear. Already, Mollenkopf and Pynoos (1973, p. 21), in their pioneering study of the impact of rent controls in Cambridge, Massachusetts, had claimed that not only had rent control failed to reduce rents, but controls had resulted in some cases in increasing the rate of return to landlords. Similar findings were reported by Daugherbaugh (1975) for Alaska.

Walker (1981) has claimed that the ceilings imposed under controls in British Columbia in 1974 and 1975 provided landlords in Vancouver with an excuse to raise rents by the maximum legal amount. He compared rent increases in Vancouver with those in Toronto (no controls in 1974). They had been similar before controls in Vancouver but were higher than Toronto subsequent to controls.

The major impact of moderate rent controls may well be the reduction in the variance of rents eliminating some of the extreme increases, but not affecting the average (Gilderbloom, 1980, 1984a).

4.3 The Purpose of Moderate Controls

The argument for moderate rent controls is that it is desirable to regulate the relationships between tenants and landlords in such a way as to provide tenants with protection from the extreme vagaries of the rental housing market. These may occur as a result of small shifts in demand bringing about potentially large changes in rents at the margin due to low short-run elasticities of both demand and supply. The aim is an equitable relationship between tenants and landlords, and to minimize the abuses associated with sellers' market power during periods of excess demand, yet at the same time to minimize the misallocation of resources associated with price controls. In different words, the strategic objective of moderate rent controls under this approach is to ensure that gap between R_e and R_c is small in either direction.

This means that binding constraints should be imposed only in periods when the rate of change in rents is likely to exceed the rates of change in long-term cost factors. Note that long-term costs reflect not only inflationary pressures but also changes in relative prices. Changes in relative prices will reflect basic demographic shifts, changes in tastes and lifestyles, and changes in the demand for various goods and services.

To be successful in seeing that the gap between R_e and R_c is insignificant except during periods of severe excess demand, it is necessary, in effect, to bring about decontrol periodically. In other words, it is possible to avoid extreme increases in rents during periods of excess demand, but it is also necessary, subsequently, to allow rents to outpace the average rate of inflation (particularly of landlords' costs) if the rental housing market is to regain equilibrium. Ceilings on rent increases must periodically be above the fundamental rates of change in the economy to provide for 'catch-up" periods, thus compensating for the times when constraints on rents were too tight. Consider Figure 7-1 in which we make the following assumptions:

- controls bind throughout the period under consideration;
- between t_0 and t_1 the statutory rate of increase is constant at level 1;
- at t_2 the statutory rate is reduced to level 2; and
- there are no cost pass-through provisions.

During the period t_0 to t_1 the nominal rate of return shrinks and may end up at t_1 in an operating loss because landlords' costs have been rising more rapidly than the statutory rate of increase in rent. From t_1 to t_2 the allowed increases in rent more than cover increases in landlords' costs, thus losses can shrink or nominal returns increase. However, political asymmetries may lead to changes in the system, setting a new lower statutory rate (level 2) at the new lower cost increases at t_2. This freezes the nominal rate of return on the book value of the building at t_2 (which could be a loss).

Ideally, if one knew how to determine R_e, one could adjust the rents to a new equilibrium whenever market conditions reflect a structural change. Although we do not know what R_e should be, there are several heuristics which permit a reasonable approximation. Fallis and Smith (CMHC, 1984), for example, have applied to the precontrol rent level in Ontario a certain multiple (less than 1) of the increases in the CPI to estimate R_e. Thus, for example, a rent adjust- ment ceiling based on a multiple of changes in the CPI may establish the maximum allowable increase in rent. The constraint must be designed in such a way that in periods of downturn or slackness in the rental housing market, the maximum allowable increase is not binding. Thus, a system where, because of controls, the gap R_e - R_c is large may need to adopt a multiplier significantly greater than one. (Alternatively, one could combine a fixed rate of increase with a variable component based on the CPI.)

Figure 7-1

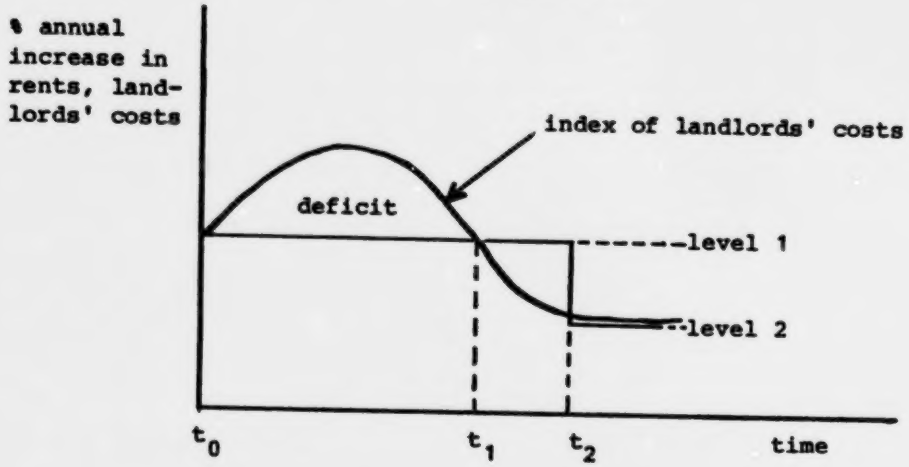


Figure 7-2

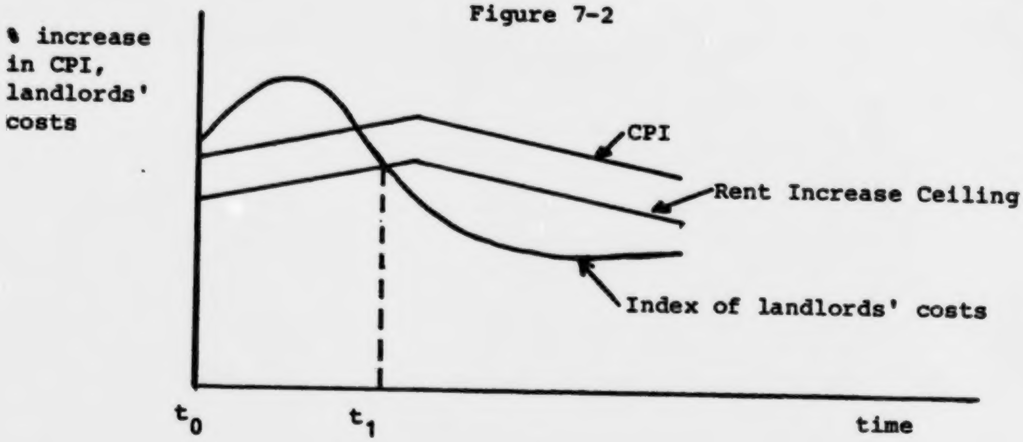
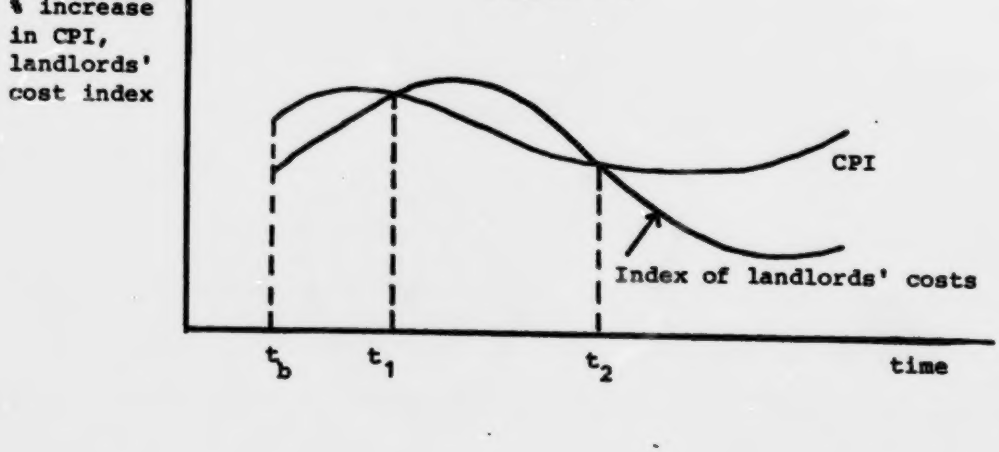


Figure 7-3



We now consider Figure 7-2 in which we make the following assumptions:

- rent controls are binding throughout the period under consideration;
- the ceiling on rent increases is set at 90% of the increase in the CPI; and
- the index for landlords' costs behaves differently than the CPI.

Up to time t_1 the increases in rent are not sufficient to maintain the nominal rate of return at time t_0. Indeed, the increase in costs may eliminate any operating profits and lead to operating losses. After t_1 the nominal rate of return increases as the rate of increase in landlords' costs is less than the ceiling rate of increase in rents.

The acid test of whether equilibrium rent levels are reached is the elimination of the gap $R_u - R_c$ within a reasonable period of time -- certainly less than a decade. But one must be careful to adjust R_c to reflect tenure discounts and the impact of amateur landlords on average rent levels (see Chapter 4). The fact that rents are lower in the controlled sector may reflect the nature of that rental market more than the impact of controls.

The choice of the specific multiple of the index must be done with two objectives in mind: (i) a gradual closure of the gap within the period of market adjustment; and (ii) an annual rate of change which is compatible with other market rates of change, in particular those related to income changes. The two objectives may be incompatible, especially in prolonged periods of increasing demands for housing. In such circumstances, it is necessary to recognize that the private sector cannot meet the needs of expanded supply without the incentives of at least immediate normal profits. The choice is in the hands of the government whether to relax the constraints and permit much higher rates of change than inflation or to expand social housing programs.

We now consider Figure 7-3 in which we make the following assumptions:

- rent controls are binding throughout the period under consideration;
- in the base year (t_b) the real rate of return on the replacement value of rental buildings is a normal rate of return;

- the ceiling rate of increase in rents is equal to the rate of increase in landlords' costs; and
- the CPI and landlords' costs behave somewhat differently over time.

The nominal rate of return at the base year t_b increases by the same percentage as the cost index. Thus the changes in the real rate of return from period to period will be determined by relative changes in the two indexes. For example, in a period where an "energy" crisis leads to much higher increases in the cost of landlords, the system will lead to an increase in the real rate of return of landlords's costs. In other periods where general inflation is higher, real rates of return will decline. Between t_b and t_1 landlords experience a declining real rate of return on their investment. Between t_1 and t_2 they obtain an increasing rate of return on their investment. Then after t_2 their rate of return declines.

While systems of moderate rent controls reduce the negative impact of the intervention, they cannot eliminate all the undesirable effects of regulation on the market. Irrespective of whether the system is moderate or restrictive, as long as controls are binding, they introduce a bias in the adjustment path of a heterogeneous market. The tendency of all systems of controls, which is to reduce variations in rents including those that are legitimate reflections of changing preferences for specific locations or neighbourhoods, distorts the efficient allocation of resources in the market. Furthermore, in the face of excess demand in the short-run, one also may expect some adjustment in the quantity of services supplied in certain portions of the market (until new construction eliminates excess demand). These costs of rent controls can be lowered if the periods of binding controls are short and effective "decontrol" periods are frequent.

Another factor which must be considered is the distortion that controls introduce through their effect on expectations, perceptions and risk levels. A system of moderate controls, even if ex post it provides normal returns on investment, may create costly distortions if landlords and tenants form incorrect expectations or are influenced by incorrect perceptions of the underlying economic facts. Furthermore, rent controls which provide a wide array of individual exemptions and adjustments often provide incentives for strategic behaviour in the market resulting in allocative inefficiency. Thus one must be careful in lumping all "moderate" rent controls as constituting one homogeneous type with a similar impact. Our analysis suggests that the choice of a specific form of "moderate" rent controls does matter. We proceed, therefore, to determine whether the Ontario rent control system is moderate. Then we examine in more detail whether its current form is causing severe distortions. We shall conclude the chapter with an examination of alternative forms which may reduce the costs of rent control.

4.4 Is Ontario's System of Rent Controls a Moderate One?

Our analysis in Chapter 4 suggests that before treating the rental market as an homogeneous entity, one ought to determine whether the assumption is correct. Therefore, before deriving policy implications for Ontario, we first analyze the nature of the rental market. In particular, we will highlight the socio-economic environment and the underlying demographic processes during the period controls have been in place. We then will examine the composition of the market in terms of ownership and tenant mobility. These analyses will permit an estimation of the significance of the amateur landlord sector, the corporate sector, and the segment of the market that is likely to be prone to illegal adjustments in rents. Examination of the evidence of types of behaviour in the rental housing market will permit a measure of confirmation of our assessments. The findings will help to interpret the prior discussion of effects in Chapter 6.

What evidence is there to suggest that Ontario's system of rent controls as presently defined has been "moderate"? We have adapted and extended the criteria proposed by Gupta and Rea (1984).

Evidence to suggest that Ontario's controls have been "moderate" rather than "restrictive" includes the following:

- Rents may be increased each year by 6% without reference to the regulatory authority. (Between July 1975 and October 1977 the statutory rate was 8%. Now a 4% level is proposed by the government.)
- Landlords may apply for a rent increase above the statutory rate and are likely to obtain it on the basis of the cost pass-through principle. While landlords representing less than one-seventh of rental units have applied any one year for a higher rate of increase, those that have done so were granted increases from four to nine percentage points above the statutory increase. See Appendix B to this chapter.
- New construction (built after January 1, 1976) has been exempt from rent controls.
- The legislation as originally enacted on December 18, 1975 was to expire on August 1, 1977. That is, there was a "sunset" clause. However, after being extended for short periods several times, the "sunset" clause was removed in late 1979, i.e., controls are now "permanent". They are supported by all three political parties in the province.
- On the other hand, the present members of the Residential Tenancy Commission are independent appointees of the provincial cabinet. However, between December 1975 and late 1979 the Residential Premises Rent Review Board consisted of 53 members, 29 of whom were "representatives of tenants".
- There is no rent registry or schedule of legal rents for each building. Hence it is easier for landlords to charge rents in excess of the legal

level. (However, the Commission of Inquiry into Residential Tenancies (1984, Ch. 17) has recommended that a rent registry be implemented.)

On the other hand, the following provisions suggest that the system of rent controls in Ontario has been "restrictive":

- There is no vacancy decontrol. Controls apply to the unit, not only to the sitting tenant. Between 1980 and late 1984 a "luxury" exemption operated for units with a monthly rent above $750.
- There are quite strict provisions in the Landlord and Tenant Act concerning conversion to other uses (e.g., condominiums) and demolitions. In addition, such as the City of Toronto, has used its control over building and demolition permits to prevent "erosion" of the stock of rent controlled units -- see Chapter 6.
- The Progressive Conservative government announced just before the last election campaign that it planned to reduce the statutory rate from 6% to 4% and to tighten controls in other ways -- see Chapter 5. (This is likely to be implemented now that the NDP holds the balance of power vis-a-vis the minority PC government.)
- The Landlord and Tenant Act contains strong tenant security of tenure provisions regarding evictions both during the course of a tenancy agreement and at the end of an agreement. See Stanbury (1985a, Ch. 4).
- When controls were enacted on December 18, 1975 they were made retroactive to July 29, 1975, the day before the Premier announced that his government proposed to bring in some form of rent review. In other words, rents were rolled back by six months to establish the base rent upon which subsequent statutory increases or those allowed by the regulatory authority.
- There is no explicit consideration of the landlord's rate of return in the cost pass-through system. However, there is a "relief of hardship" provisions that allows an increase sufficient for the landlord's revenues to exceed his cash costs by 2%.

- Tenants may apply to the regulatory body to challenge a statutory increase by a landlord on the grounds of comparability of rents in the same geographical vicinity or because there has been a deterioration in the standard of maintenance and repair that affects the rental unit.
- Since the 1982 Interim Act cost increases following the purchase/sale of a controlled building associated with increased financing costs may not result in a rent increase of more than 5%.
- Tenants may challenge a landlord's application for a rent increase by questioning the increases in costs presented by the landlord or by arguing that there has been deterioration in the standard of maintenance and repair in the rental complex or in any rental unit.
- In October 1984, the government said it would introduce a rent registry. This will make is much harder for landlords to charge more than the legal rent. (See Stanbury and Thain, 1986, Ch. 9.)

Thus the design contains features indicative of both restrictive and moderate controls. If one, however, considers the history of rent controls in Ontario (see Chapter 5), one must conclude that the trend is toward a more restrictive system. The pattern in Ontario appears to be consistent with that often observed elsewhere after rent controls have been put in place.

In most jurisdictions rent controls were initially imposed in response to a perceived crisis in rental housing, usually associated with rapidly rising rents (faster than CPI and household incomes). Subsequently, controls have tended to exacerbate the supply problem and they have continued in existence as new rationales have been found to support them in the political arena. (Objectives 2, 4, and 6 fall into this category.) Regulation creates new interests in its perpetuation.

Schemes of rent regulation are not static. They are continually altered to reflect new economic and political realities. In general, the changes extend the scope of the controls, although occasionally controls are liberalized to reduce the gap between the controlled rent and the market level of rents.

The acid test is whether the observed gap $R_u - R_c$ is closing. Fallis and Smith (1985a) have provided an estimate of the gap for Metro Toronto in November 1982. The gap was of a significant size (23%). We believe that the gap grew in 1983 and stabilized in 1984. Indeed, as we have argued in Chapter 5, the fixed level automatic rent adjustment permits a closure of the gap in times of low inflation. However, the recent proposals of Ontario's provincial government to reduce the statutory rate of increase from 6% to 4% (discussed in Chapter 5) may reverse the process of closing the gap.

The combination of $R_u > R_c$, the political dynamics which appear to tighten the rent regulation, and the significant increases in transaction costs for using the regulatory system (see Table 5-4) no doubt will lead to:

(i) Increases in the price per unit of housing services in the controlled/corporate-owned sector through quantity and quality adjustments. (It should be noted that while code-compliance provisions are in effect, in practice they are rarely used because of high transactions costs to tenants. Furthermore, tenants have few incentives to enforce conservation expenditures by landlords.

(ii) Significant reduction in investment plans for rental building construction irrespective of exemptions (i.e., the impact of the reduced cash-flow indicated in Framework 3). This trend can be (and indeed was)reversed by publicly-funded incentives schemes which improve cash-flows in the short-run.

(iii)An upgraded mix of rental units offered in the exempt sector.

(iv) Where the gap between R_u and R_c increases it will likely lead to significant increases in the number of landlords who adjust rent illegally. This will be especially the case if rent review procedures will incur high transaction costs.

To assess the impact of the specific characteristics of the Ontario rent control system (and the possible distortion this may bring about), it is necessary to establish first the characteristics of rental housing markets in Ontario. These are summarized in Appendix B at the end of this chapter. The analysis will then permit us to use the three analytic frameworks developed in Chapter 4 to identify possible consequences of existing characteristics and potential amendments to the rent controls.

From Appendix B, it is clear that there are many diverse markets in the Ontario system. Therefore, the system will affect different markets in different ways.

Generally the data suggests that there is a significant segment of landlords in the market which can be characterized as having "idiosyncratic" relationships with tenants or which reflects the characteristics of the amateur economy (Framework 3). This segment of landlords in our estimates constitutes about one-third of the market. We base this figure on the fact that 33.8% of all rental units in the ten Ontario CMAs were in buildings with fewer than six units (MOMAH, 1983, p. 15). Further, 81% of landlords in a survey representing 70% of Ontario's rental stock own only one building. Moreover, in 1975, 46% of rental units in Metro Toronto were in buildings with one to seven units, three-quarters of which were owned by individuals or by a partnership. The idiosyncratic nature of the relationship is illustrated by the fact that an estimated 22% of the units each year between 1976/77 and 1980/81 did not have any increase in rent. One-quarter of the units in the market are controlled by what we can describe as large corporations having specialized professional planning and management personnel. We base this figure on a survey of landlords covering 70% of the Ontario market which found that 25.8% of rental units were owned by landlords who owned five or more buildings (MOMAH, 1983, p. 17). The remainder of the market (about 40%) consists of smaller corporations and of those individual landlords with relatively large holdings.

Examination of the economic environment suggests that the years 1974-76 and 1980-83 represented periods of great uncertainty for the housing market with sharp discontinuities in cost patterns. While the housing market as a whole is typically cyclical, change rates in these periods exceeded the typical range of cyclical fuctuations.

5.0 IMPUTED CONSEQUENCES AND PREDICTIONS: USING THE ANALYTIC FRAMEWORKS

As we have observed the type of data we have for assessing rent controls in Ontario does not permit a formal statistical analysis relating characteristics to effects. (The observations are confounded and a decade is too short to assess long-term effects in a housing market in a precise way.) Therefore, we must use theories to impute specific relationships. We consider a 3 x 2 matrix of types of landlords (market segments) and types of economic environment in Figure 7-4. Each combination of type of landlord and type of environment provides us with an indicator as to what analytic frameworks provide the better fit for predictions or assessments. The major predictions and observations are summarized subsequently in Boxes 1 to 6. (To gain further insights, it is desirable to refer to the detailed descriptions of the analytic frameworks in Chapter 4 and the specific design implications provided in that chapter.)

What is clear is that the specific characteristics of controls, their timing, and the way they are implemented may lead to significant differences in behaviour in the rental market. Thus while the major, desirable strategic attribute of a rent control design is the gradual closure of the rent gap R_e - R_c the alternative means for achieving this objective may make a significant difference. We therefore consider several alternative approaches of potentially moderate rent controls.

Figure 7-4

Type of Landlord and Economic Environment

Estimated Segment of Ontario Market(%)	TYPE OF LANDLORD (segment of market)	ECONOMIC ENVIRONMENT	
		Stable (may be steady inflation or no inflation)	Discontinuous/ Unstable
About 25% of units	Large corporation (professional landlord)	BOX 1	BOX 2
About 42% of units	Small corporations and individual landlords (with higher tenant turnover)	BOX 3	BOX 4
About 33% of units	"Amateur" landlord/ "idiosyncratic exchanges"	BOX 5	BOX 6

BOX 1

General: Decision made on the basis of economic calculations. Transaction costs are low.

Response to Regulation:

- Invest in new construction if $R_e > R_c$, irrespective of controls (i.e. rates of return permitted should yield at least normal levels). This assumes there is an exempt sector. Plans for new construction are sensitive to long-term demographic and economic factors (e.g., interest rates).
- Adjust quantity of housing services per unit to optimize.
- Consider conversion.
- Use intensively the regulatory machinery to obtain maximum net benefits. If pass-through provisions provide for normal rates of return on invested capital then invest for as long as the market will bear.
- Luxury decontrol and liberal conversion statutes in combination with generous pass-through provisions will encourage stock upgrading and overexpenditures relative to equilibrium.
- Pass-through of increases in financing costs will lead to higher turn-over in ownership.
- Pricing policy in exempted sector is economic pricing (spill-over from controlled market is perceived as having a positive impact on rentals in the uncontrolled sector).
- Significant unplanned changes in control statutes will be considered a major discontinuity and result in the consequences described in Box 2.

BOX 2

General: Decisions made on the basis of economic calculations using expectations. Expectations may lag and response to changes will be relatively slow. Risk avoidance (i.e., demand high risk premia). Very high degree of uncertainty may lead to decision making described in Box 3.

Response to Regulation:

- As in Box 1 but normal rates of return include higher premium for environmental risk and risks associated with controls.
- Environmentally adaptive features of controls (e.g., CPI dependent formulaes of rent adjustments) will reduce risks and the premia that must be added to returns.
- Pass-through provisions for cost increases will reduce risk. The added uncertainty in the environment, however, will reduce the attractiveness of investment in upgrading even when liberal pass-through provisons are permitted.
- All changes making rent controls more restrictive as well as generally a more interventionistic posture by government in the economy are translated in to higher risk premia.

BOX 3

General: Small corporations develop rule of thumb to deal with the complex market. If the market is stable these heuristics are refined and in the long run will approximate 'rational economic decision making'.

- In the short-run, decision making is myopic thus showing high sensitivity to cash-flows. Hence government subsidies to new construction will have a strong temporary impact upon new building in this sector even when the long-term economics does not justify new investments.

Response to Regulation:

- If the gap $R_e - R_c$ is very large and enforcement effort moderate, "black market" practices will develop. In the absence of a rent registry and tenant organizations illegal rent adjustment to close the gap is highly likely upon vacancy. These illegal practices are more likely in the case of very small corporations. Similarly, black markets will evolve in these sectors characterized by high turnover of tenants.
- The larger corporations in this sector which comply with the regulation will do so as long a positive cash-flows can be guaranteed. Liberal pass-through provisions are essential to preserve maintenance and repair expenditure levels.
- Since cash-flow will be affected negatively by capital outlays which can pass-through to the tenant only gradually, these will be a minimum of upgrading or renovation.
- If transaction costs are high, the tendency of landlords in this sector will be to opt for the statutory rent adjustments or illegal adjustments.
- Formulae of statutory rent adjustments which respond sensitively to changes in the economic environment (costs) will reduce risk and maintain cash flow. Such formulae will reduce sharp fluctuations in maintenance and service levels and plans for investment that will result from changes in cash-flow.

BOX 4

- General: As in Box 3 except there is no mechanism of learning that leads to convergence of behaviour to "economic behaviour". The effects of higher "risks" are translated to higher requirements for "cash reserves". Avoiding "risk of ruin" is a strong motivator of decision making.
- Response to Regulation:
  As in Box 3 except there is a higher tendency to adopt illegal practices, especially when controls involve long delays in automatic individual rent adjustments.

BOX 5

- **General**: Although "idiosyncratic" landlords and amateur landlords are motivated by different factors, we treat them for policy analysis as a single group since their responses to rent control features and their general behaviours in the market are similar. Both groups are characterized by relationships with tenants that keep rent changes to a minimum and provide for informal accommodation mutually benefitting landlords and tenants. Both groups can absorb non-cash cost increases, but are sensitive to cash-cost increases.

Response to Regulation:

- Controls are ignored to a large extent by both groups but rent increases may be below the statutory level. (See Table 6-43.) Accommodation outside controls will be made with tenants regarding maintenance, services and upgrading.
- Highly publicized automatic rent level adjustments in the controlled sector is likely to bring about similar "catch-up" rent adjustments upon vacancies.
- Increasing the "restrictiveness" of tenure protection rules for tenants may threaten the type of close relationship in this sector of the market.
- Shared concept of fairness regulates the relationship between landlords and tenants. Resorting to the regulatory machinery signals the breakdown of the relationship.

BOX 6

- **General**: As in Box 5.
- **Response to Regulation**: As in Box 5. But the position of such landlords will be severely treatened during periods of severe cost-pust inflation when landlords cash costs necessitate rent increases to cover cash flow. Sharp rent increases outside the control system may rupture the relationship.

6.0 ALTERNATIVE DESIGNS FOR MODERATE RENT CONTROLS

In this section we examine several alternative designs for moderate systems of rent controls. We consider both their benefits and their shortcoming. We assume that the central purposes of a well-designed system of rent regulation are the following:

- minimization of the opportunities for rent gouging during periods of excess demand; (this is a social goal.)
- effective, periodic decontrol, that is, return to a "market discipline"; (to assure allocative efficiency)
- low transaction costs for all the actors; (technical efficiency)
- incentives for compliance by both landlords and tenants; and
- elimination of expectations that could result in counter-productive behaviour. (The last two are concerned with administrative efficiency.)

Indeed, if the system is perceived to attain the first three purposes it is likely to achieve compliance and reduce counter-productive behaviour. We now consider several alternative designs for systems, rent regulation and evalute their essential attributes.

Design 1: Minimal Interference Arbitration

An example of this design was the system in Manitoba before the Residential Rent Regulation Act (1982) was reinstated -- see Stratford (1982). The Landlord and Tenant Act in Manitoba did not place numerical ceilings on rent increases. Rather, it attempted to establish an arbitration process. A tenant could protest the amount of a proposed rent increase before the Rentalsman within a month after receiving notice of the increase. Such a notice led to mediation.

If mediation did not result in an agreement the matter was referred to the Director of Arbitration. If the landlord objected to arbitration, the Director was required to satisfy himself before proceeding that the rent increase was excessive and that alternative comparable accommodation in the same general area in which the residential premises were situated was limited. An "excessive" rent increase was defined on a comparative basis, i.e., the existing local market.

Benefits:

- This system resulted in minimal interference with the allocation of rental units on a decentralized basis by market forces.
- By permitting higher rates of return during periods of excess demand, incentives are created for a much more rapid increase in the supply of units.
- Low transaction costs. The system is triggered only by a tenant complaint.
- This system reduces the opportunities for landlords to extract unfair advantage by exploiting a tenants' high cost of moving.
- This system minimizes attempts to eliminate tenure protection rights by means of unwarranted rent increases.

Shortcomings:

- This system does not provide an effective mechanism for reducing general (as opposed to individual) rent "gouging" in a period of excess demand. As Stanbury (1985a, Ch. 2) emphasized, there are several concepts of "gouging". By general gouging we refer to the situation where a period of excess demand will permit landlords to increase rents much faster than their increase in costs. As a result, landlords will earn returns on their investments that are above normal. Rents will climb temporarily above those that are likely to prevail in the long run. Thus, the market value of their buildings will rise so as to produce a "windfall" capital gain.

Design 2: Voluntary System With A Mechanism to Settle Rents When Disputes Arise

The Landlords and Tenant (Residential Tenancies) Act of Newfoundland provides an example for a system of rent controls which is triggered by the request of a landlord or a tenant -- see Stratford (1982 and 1985). The

Residential Tenancies Board has the power to fix changes in rent for residential dwellings at the written request of a landlord or tenant. The Board holds a hearing into the matter at which time evidence can be produced by either the landlord or the tenant. The Act provides that in setting the amount of rent increase the Board shall take into account the following (as well as other) factors: a fair and equitable return on investment, the current fair market value of the rental premises, all reasonable operating expenses, and the quality of life and shelter.

Benefits:

- There is no government interference in situations where voluntary agreements between landlords and tenants can be reached. For the majority of cases, there are low transaction costs.
- The uncertainty involved in going to the Board and the high transaction costs associated with the formal resolution of the dispute may induce agreement.

Shortcoming:

- The system requires a fairly high degree of sophistication on the part of landlords and tenants. The uncertainty involved is asymmetrical and favours the landlord with large holdings.
- The system may involve periodic high transaction costs to all parties (including the government). It is a system which works in periods of stability but is likely to become clogged in periods of excess demand or where landlords' costs are sharply rising. Disputes are likely to arise when the gap in the perceptions of landlords and tenants of what are the economic realities may be large and irreconcilable.
- The lack of a specific formula for rent adjustments may lead to inequitable and inconsistent decisions. (This can be remedied by the development of detailed guidelines by the regulators as is the case in Quebec by the Regie du Logement.)

- The use of a current "market value" as a basis for determination of fair returns is contentious. The "market value" will reflect the capitalized value of the higher rents when the market is in disequilibrium and shortages occur. Thus the use of "market value" is a basis for calculating rents of return will not prevent "excess profits" to owners of the existing stock. On the other hand, if fair market value is determined only in terms of future rental levels in equilibrium, this problem will be eliminated. (Of course, what these elusive equilibrium rents are is not clear.)

Design 3: A Combination of Automatic Adjustment and Individual Review Upon Request

This design has many variations, for example, the Ontario rent control system, and the Nova Scotia rent control system. The major differences between the various options available are the bases for the automatic adjustments in rent, and what is taken into consideration when individual rent reviews are conducted. The precision of the formal rules and the degree of discretion which is left to administrators are other important factors which differentiate system designs.

We consider here two variations in the basic design. The differences between these variants of Design 3 are significant and can be treated as separate designs. Other designs can be generated by combining different types of automatic adjustment and different guidelines and procedures for individual rent reviews.

Design 3A: Fixed Adjustment Ceilings Determined by Legislation and Cost Pass-Through System Without Specific Attention to Landlord's Return on Equity

The Ontario system, described and analyzed in detail in Chapter 5, is an example of such a system. The fixed maximum annual percentage increase can be changed in Ontario only by legislation . Although this "guideline rate" is changed occasionally, it may require an action by the legislature and this makes such a change more costly. Hence it will be less frequent. Entrenching the guideline rate in legislation also means that political considerations are paramount in determining the rate once a proposal for change is brought forward. Thus, given the political calculus of voter maximization, those parties who prefer tightening of controls are more likely to bring forward proposals for change than those who, on ideological grounds, argue that the capping of rent increases should only be temporary. (Of course there are exceptions associated with political manoeuvres before elections.)

The optimal individual review process which augments the automatic general rent adjustments in this design is intended to deal with cases of financial hardship and inequity suffered by landlords (and to a lesser degree, complaints of tenants), and provide incentives for landlords to maintain and improve their units. Only if the automatic adjustment is generous enough (i.e., bringing about frequent closures of the rental gap $R_e - R_c$) can the system be considered "moderate" rather than "restrictive".

Benefits:

- The fixed guideline rate is predictable. It may lead to counter-cyclical adjustment. That is, rents are kept below the rate of inflation in periods of high inflation and the catch-up is possible (if rent adjustment ceilings are high enough) in periods of low inflation. Recall Figure 7-1 above.

- The application of the guideline rate is simple and involves few transaction costs.

- The option of individual rent adjustments upon application by landlords provides them with escape-hatches to reduce the risk of ruin, i.e., failure to cover cash costs. Rights for individual adjustments triggered by tenants provide them with means to enforce maintenance standards and reduce the chance of "hidden rent increases" (i.e., landlords raising prices by quantity adjustments).

Shortcomings:

- If the guideline rate of increase in rents is too low the transaction costs of the system are likely to be very high as a higher proportion of units are taken to rent review on a cost pass through basis.
- Risks in the system are high for landlords -- their rates of return can erode in periods where their costs are rising rapidly -- see Figure 7-1. If one considers the political dynamics of rent control, it is likely that once the guideline rate is higher than inflation it will be lowered to the rate of inflation, hence preventing landlords from "catching up". The converse is not true, however. In periods of high inflation controls are perceived as a tool to reduce inflation in general or at least the rate of increase in an important component of the basket of services and goods consumed.
- Cost pass through formulae that are complicated and restrictive will involve high transaction costs but may have a low impact on the behaviour of landlords. They also provide asymmetric advantages to those enjoying economies of scale in rent control transactions (i.e., landlords with large holdings, organized tenants, etc.).
- The impossibility of fine-tuning incentives leads often to over- or under-investment in maintenance and improvements.
- The possibility of abuse encourages turnover of rental buildings.

Design 3B: An Index-Based Variable Automatic Adjustment Ceiling, with an Option for Individual Review Based upon the Criterion of Maintaining Normal Returns on Investment

In contrast to Design 3A, in this design there is an effort to achieve consistency between the general statutory increase and the one calculated in the review process. Both should attempt to provide a normal rate of return on investments in rental dwellings. In Design 3A the general increase is set so that nominal rent increases are generally capped to achieve smoothness, while individual adjustments are designed to provide some relief to landlords who experience financial losses and/or face significant cost increases not covered by the general adjustment (guideline rate). These building-by-building adjustments may be significant and in contradiction to the objective of ensuring smoothness of change in rents.

To achieve the objective of maintaining a normal rate of return on investment in rental properties, the general statutory increase should provide for average increases in costs as well as increases in the net income needed to maintain a normal rate of return on invested capital. (The net income component should be adjusted to reflect changes in interest rates and capital values, but not adjusted to reflect tax advantages.*) Since the stock of housing is not homogeneous, the option of rent review for an individual building is available to landlords whose units experience significantly different increases in costs than the one reflected in the indexes used to calculate the general adjustment (guideline rate). Tenants may use it to ensure that landlords do not adjust the quantity of services in order to increase their profits as well as to ensure that they pass-through any reduction in operating costs.

Benefits:

- The system can prevent general "gouging" (as defined above) during periods of excess demand but, depending on how the pass-through provisions operate, some tenants may still expeience large increases.
- The system should have no deleterious effects upon maintenance, repairs or renovation plans.

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* If adjustment is made to reflect tax advantages, the impact of taxes as an instrument of government policy (i.e., providing incentives for increased supply) will be eliminated.

Shortcomings:

- The system may create short-term shortages in the controlled sector and thus reduce the mobility of tenants. This short-term effect should not be significant.

- Transaction costs may be high if the stock is heterogeneous and a majority of landlords and tenants use the rent review process. A system with several guideline levels based on more refined cost and rate of return indexes for specific segments of the housing market may solve this problem.

- The system (like most regulatory mechanisms) may bring about a level of equalization which may distort the path of the development of urban areas. The individual review can accommodate special conditions but it does so at a price, namely -- much higher transaction costs for all the parties involved. A generous multiple of the index which will lead to frequent effective decontrol will reduce the problems.

Design 4: A Decentralized, Voluntary System With a Predictable Formula for Resolution of Disputes About Rent Adjustments

The system which exemplifies this design is the system of rent controls in the Province of Quebec -- see Stratford (1982 and 1985).

The basic philosophy underlying the system is that rent level increases should be determined through fair negotiations between tenants and landlords in a decentralized way. The formula said to provide for a fair rent increase is suggested by the regulators and is publicized widely. Indeed, the formula and its method of use are those the regulators use when matters are referred to them after tenants and landlords cannot come to agreement. It is suggested, however, that in negotiations between landlords and tenants other qualitative factors should be considered, that is, recognizing the benefits of idiosyncratic relationships between tenants and landlords. The resort to the Regie du Logement -- the rent review board -- is viewed by the regulators as the exception rather than the rule. Indeed, according to Stratford (1982, p. 144) approximately 97.5% of the requests for rent increases are settled without taking them to the Regie. The Regie intervenes when negotiations between landlords and tenants fail and an application for determination of a rent increase is received from a landlord after a tenant has refused the proposed rent increase. A hearing is held at which both the tenant and the landlord makes representations. The landlord must provide financial details and a proof of their accuracy if requested. The Regie follows a precise and published method for the computation of rent increases. The use of this method is obligatory.

The method is based on adjustment of the old rent to reflect changes in costs (taxes, utilities, maintenance), and an indexing of the net income component. The indexing reflects prevailing interest rates. The Regie rarely questions the appropriateness of the existing rent. Rather it takes it as given and it becomes the base for the determination of the new rent. To the base, the Regie adds the calculation of cost increases including specific price indexes derived for different types of fuels, the actual change in property taxes, and insurance bills. It uses a price index of operating costs to estimate the change in this component of landlords' costs. Management costs are estimated to be 5% of the potential annual income before adjustment. Net income before adjustment is calculated and multiplied by an index reflecting market changes in the mortgage interest rates.

The sum of increases in costs and net income is added and divided by the base unadjusted rent (x 100) to compute the percentage rent increase. Increases are also calculated for improvements in a way which will provide a normal rate of return on the added investment.

New buildings are exempted from controls for five years after they come on the market.

Benefits:

- This design minimizes direct intervention by the regulatory body by encouraging voluntary agreements.

- This system facilitates agreements between landlords and tenants by providing information and a detailed format for the calculation of rent increases.

- This design facilitates decentralized landlord-tenant agreements by the prospect of high transaction costs (lengthy formal procedures) if negotiations fail. It encourages voluntary agreements by providing a useful mechanism for calculating the increase the regulator is likely to grant.

- The system does not freeze the landlord's net income and relates it to changes in mortgage interest rates.

Shortcomings:

- If the base rent does not provide a normal rate of return on a landlords' investment then the method by which the Regie increases rents will not correct the problem. However, only a small percentage of cases end up before the regulator.

- To succeed and maintain equity the design requires a certain level of sophistication on the part of tenants and landlords.

- The fact that the rent level in the previous year forms the base for rent increases means that a landlord must increase the rent each year in order to maintain the base for future years. This problem can be remedied by providing an option that allows for determination of rent on the basis of rents charged for comparable units in the same location, or permit a projection from a base year other than the last (i.e., a landlord who chose not to increase rent in a particular year can catch up in a later year).

- The system may not provide sufficient incentives for tenants and landlords to negotiate in good faith, although the evidence for Quebec indicates only a small fraction of cases are not resolved privately.

A modification to reduce nuisance refusal to negotiate by tenants and negotiation in bad faith by landlords would be to require the regulator to choose between the last counter offers for rent levels of the landlord and the tenant. The choice should depend on the degree to which each offer approximates the criteria of the regulatory authority.

7.0 SUMMARY AND CONCLUSIONS

- There is no doubt that rent controls in Ontario have brought about a significant moderation in the average rate of increases in rent in the controlled sector over the decade they have been in effect. The costs of this change in the pattern of rent increases have not yet been fully reckoned.
- Our major conclusion with respect to other effects, however, is that the Ontario rent control system is essentially restrictive, although we have identified some design characteristics that suggest it is a "moderate" system. However, due to high transaction costs these features do not provide an adequate adjustment mechanism to ensure the gradual closure of the rent gap (R_e - R_c). But it appears that a certain level of moderation was introduced through passive enforcement and the tacit tolerance of illegal market adjustments. These may explain the fact that the observed reductions in services, maintenance and repairs were not as significant as they could have been, given the size of the rent gap. The trend toward higher transaction costs for those who use the rent review process noted in Chapter 5 means there is a higher incentive for black markets to expand.
- There is a significant sector in the market (the amateur/idiosyncratic landlord sector) which appears to have ignored controls to some extent. But this sector fulfills many of the control objectives without the usual costs associated with regulation. As long as the system remains restrictive, the survival of this sector depends on the continuation of a passive enforcement policy (i.e., allowing for voluntary agreements which violate the regulations).

- The evolution of rent controls in Ontario has been toward a more restrictive system. Even if the economic realities would justify investment in new rental units, our analysis suggests that the perceived risk and the "investment climate" that are generated as the system evolved is likely to result in a low level of private investment in the next decade, ceteris paribus. To assure an adequate supply of new rental units, "public housing" programs are essential, but this will be costly to taxpayers. (In present value terms the cost per unit could range from $20,000 to $50,000.) The "private" alternative requires a significant formal liberalization of controls and a focus only on the objective of preventing gouging in periods of excess demand.

- There are several alternatives which could be considered to bring about a truly "moderate" system of rent controls:

(i) A decentralized voluntary system with a centralized binding dispute resolution mechanism (Design 4 above); such a system which adjusts rents to compensate for cost increases and provides for economic rates of return. The system should be designed to ensure that the rent for most units would be agreed upon voluntarily by tenants and landlords rather than determined by a regulatory body.

(ii) An index-based, automatically adjusting rent ceiling with the option of individual review to see if normal rates of return on investment are being earned. (Design 3B) appears to provide a reasonable balance between costs and benefits. The success of the design will depend on the committment of the government to supply adequate funds to the regulatory body and the formal requirement of that system to achieve a certain level of minimal performance (e.g., a limited permissible span for processing times of individual applications).

We presented examples of alternative rent control systems which meet the design criteria we have previously identified. Indeed, other alternate designs could also be generated. The specific choice, however, cannot be made without considering other government policies which significantly affect the rental housing market -- see Chant (1985). Furthermore, the priorities which must be placed upon different objectives depend on expectations or projections with respect to selected future demographic and economic trends. The Commission of Inquiry is now conducting studies which will provide much more detail on some of the principal trends, and will assess other government policies which affect the rental housing market. We hope that with these studies at hand the framework and insights developed in our research may assist policy makers in choosing among the alternatives. At the same time, we appreciate the fact that technical analysis is often overridden by political pressures when a government deals with rent regulation. At the same time we would remind politicians of Edmund Burke's observation: "Having first looked to government for bread, on the very first scarcity they will turn and bite the hand that fed them." Moreover, Burke also reminds us all that "example is the school of mankind, and they will learn from no other." The pity is that we seem to have to learn from our own example rather than from the experience of others.

Appendix B

(to Chapter 7)

KEY CHARACTERISTICS OF THE RENTAL HOUSING MARKET IN ONTARIO

1.0 CHARACTERISTICS OF LANDLORDS

- In June 1975 in Metro Toronto rental buildings with one to seven units (n = 155,700) accounted for 45.8% of all rental units (n = 339,700), excluding single family dwellings with boarders (n = 125,600). The 155,700 rental units excludes 19,980 units in rental buildings occupied by the owner.

- The ownership of these small rental buildings with one to seven units was as follows:

  - 75% by individuals or jointly owned (including 21% owner-occupied);
  - 18% by corporations; and
  - 7% by non-residents of the municipality. (Ministry of Treasury, Economics and Intergovernmental Affairs, 1975.)

- In 1981 some 33.8% of all rental units in Ontario were in buildings with fewer than six units while 49.9% were in buildings with 50 or more units.

- A survey in 1980 covering 70% of the rental stock in buildings of 6 or more units in Ontario found that 81% of landlords of all types owned only one building. These buildings (n = 4676) accounted for 48% of the rental units in the sample. The distribution of types of owners of only one building was as follows:

- individuals	26.4%
- husband and wife	19.8%
- partnerships	16.8%
- corporations and numbered companies	33.1%

However, corporations and numbered companies obviously owned larger buildings as they accounted for 67.4% of all units where the landlord owns only one building. At the other end of the distribution, only 75 corporations or numbered companies in 1980 owned six or more buildings but they accounted for 20.7% of all rental units in buildings with six or more rental units.

- The distribution of some key characteristics by type of owner of rental buildings of six or more units in 1980 in Ontario:

Landlord	average building size	% of all buildings	% of all units
- Corporate	163.4	33.0%	71.6%
- Numbered Co.	124.6	3.0	4.8
- Husband-Wife	18.6	17.0	4.3
- Partnership	42.2	15.0	8.4
- Individuals	19.7	38.0	7.3
- In - Trust	60.5	3.4	2.7
- Other	140.0	0.3	1.0
Total	75.3	100	100

(Pringle, 1985, Table 2.6; 2.7).

- The structure of total rental stock in Ontario in 1971, 1976 and 1981 was as follows:

	1971	1976	1981	% tenant occupied
- Single detached	19.6%	14.2%	14.9%	9.7%
- Single attached	20.8	18.2	18.1	38.4
- Apartments	59.4	67.3	66.5*	91.7
- Mobile homes	0.1	0.2	0.4	14.8
Total	100 %	100 %	100 %	36.7
n =	825,000	958,000	1,091,000	

- In 1981, Ontario's occupied rental stock was composed of the following types of buildings:

- Single detached	15.0%
- Single attached	13.5
- Duplex	4.6
- Apartments	
≤ 4 stories	26.8
5 + stories	39.8
- Mobile homes	0.2
	100 %

- The renter-occupied dwelling stock is a much higher fraction of the total housing stock in the City of Toronto than in the province as a whole:

- 1971	130,710	58.2%
- 1976	134,905	58.6
- 1981	142,995	59.3

- In 1981, the distribution of the total rental stock for the ten Census Metropolitan areas in Ontario and for Toronto CMA by size of building was as follows:

no. of units	Ontario	Toronto
under 6	33.8%	26.5%
6 - 19	7.0	4.8
20 49	9.3	9.1
50 - 199	29.8	31.9
200 +	20.0	27.7

- In 1981 the age distribution of all tenant-occupied dwellings in Ontario was as follows:

≤ 5 years	10.1%
6 - 10	12.0
11 - 20	18.4
21 - 35	28.8
36 - 60	17.4
61 +	13.4

Pringle, 1985, Table 2.3).

- Between 1976 and 1981 some 131,000 rental units were built in Ontario. Of these, 45,000 were socially-assisted and 86,000 were privately-initiated units (Pringle, 1985, Figure 4.1).

- In 1984 Pringle (1985, p. 137) estimated that about 63,000 condominiums or 39% of the total in Ontario were rented. In other words, rental condos amounted to 6% of the rental stock. In December 1984 a survey of the almost 9300 condominium units in the City of Toronto revealed that 14.3% were vacant, 53.6% were owner-occupied and 32.1% were tenant-occupied. A survey conducted in July 1984 found very similar percentages. It also revealed that 43% of the condominium stock were MURB units and that 67.5% of the tenant-occupied condominiums were MURB units (data provided by Eric Adams of the Thom Commission).

- The size and age distribution of larger apartment buildings in Metro Toronto in 1980 were as follows:

Size	Year of Construction		
	< 1960	1961-75	1976-80
20 - 49 units	988	79	7
50 - 199	427	576	21
200 +	19	256	25
	1434	911	53
100%	60%	38%	2%

These data suggest that these buildings, which account for 67% of the province's total rental units, were on average 22 to 25 years old. A survey of low-rise rental buildings (one to seven units) in Metro Toronto in mid-1975 found that their average age was 56 years. (Ministry of Treasury, Economics and Intergovermental Affairs, 1975.)

2.0 CHARACTERISTICS OF HOUSEHOLDS AND TENANT HOUSEHOLDS

- The average size of Ontario households has been declining steadily:

1961	3.7 persons
1966	3.6
1971	3.4
1976	3.1
1981	2.8

(Pringle, 1985, Table 1.1)

However, in 1981 the aveage size of tenant households was 2.1 persons (Pringle, 1985, Table 1.9).

- Clayton Research (November 1984, Appendix, Table A-14) provides data from the Census showing the growth in the number of one- and two-person renter households in Canada:

	1951	1961	1971	1981
1 person	39.7%	46.4%	63.1%	68.1%
2 person	38.0	36.7	45.5	41.3
all households	34.4	34.0	39.7	37.9

- In 1961 families made up 82.2% of all renter households and non-family, single peson households accounted for 12.7%. By 1981 the comparable percentages were 56.1 and 36.5% respectively (Clayton Research, November 1984, Appendix, Table A-8).

- The composition of households in Ontario is also changing:

	1971	1981	2001
- Families with children	50.8%	42.3%	41.5%
- Single parents	6.6	7.9	8.6
- Couples and singles	40.3	48.5	48.5
	100	100	100

(Pringle, 1985, Table 1.7)

- In 1981 some 41.1% of tenant households lived in the Toronto CMA. Another 8.6% and 6.0% lived in the Ottawa and Hamilton CMAs respectively.

- In 1980:

  - 66% of unattached individuals were tenants
  - 59% of female single parents were tenants
  - 41% of male single parents were tenants
  - 19% of couples with children were tenants

(Pringle, 1985, Table 1.11).

- In 1981 Ontario had 2,970,000 households. The ten CMAs accounted for 1,968,000 or 66.3% of the total. The five largest CMAs were:

- Toronto	1,040,000
- Ottawa	200,000
- Hamilton	190,000
- London	106,000
- St. Cath/Niagara	106,000

(Pringle, 1985, Table 1.2)

- The ratio of tenant-occupied dwellings in Ontario has increased:

1961	29.5%
1966	32.9
1971	37.1
1976	36.4
1981	36.7

(Pringle, 1985, Table 2.1)

- In 1981 the size distribution of Ontario tenant households was as follows:

1 person	38.1%
2 persons	31.1
3 "	14.1
4 "	10.2
5 "	4.2
6+ "	2.3

The average is 2.1 persons

(Pringle, 1985, Table 3.9).

- The average rent-to-income ratio for Ontario households across ten CMAs was 20.5% and ranged from 19.6% to 21.7%. This is based on mid-1981 rents and 1980n income (Pringle, 1985, Table 3.7).

- In Ontario in 1981 some 55.1% of households had a rent-to-income ratio (1981 rent / 1980 income) of 20% or more. For other thresholds it was as follows:

25+ %	38.6%
30+ %	28.8%
35+ %	22.7%

(Pringle, 1985, Table 3-10).

- In 1981 the average monthly rent in Ontario for buildings built prior to 1976 (therefore subject to rent control) was $277. The average for buildings built between 1976 and 1981 (and therefore exempt from controls) was $326 -- a difference of 17.6% (Pringle, 1985, Table 4.3).

- In 1981 some 1.5% of tenant households paid $750/month or more on rent. The figure was only 2.9% for those with incomes above $25,000 in 1980 (Pringle, 1985, Table 4.11).

- MOMAH (1983, p. 7) suggests that the rate of growth of the total population of Ontario will decline over the next two decades in terms of five-year growth rates:

1971-76	7.3%	1986-91	3.1%
1976-81	4.4	1991-96	3.1
1981-86	3.8	1996-2005	1.2

- MOMAH (1983, p. 10) also suggests that the growth rate in new household formation will decrease:

	average annual increases		
1971/76	81,400	1986/91	52,000
1976/81	67,000	1991/96	38,200
1981/86	58,400	1996/2001	28,600

3.0 SOCIAL HOUSING

The Ministry of Municipal Affairs and Housing (1983) states that

- In 1982 Ontario Housing Corporation, a Crown corporation established by the Province in 1964, supported 115,524 rental units with rent-geared-to-income subsidies estimated to cost $309 million in 1983. The average monthly subsidy was $238 (pp. 3, 58).

- About 20% of Ontario's rental stock of about 1.1 million units in 1982 was developed with direct assistance from government. Most of the approximately 215,000 rental units brought on stream with direct government financial aid have been created in the past 15 years (pp. 2-3).

- Between 1976 and 1981, "direct government subsidies were a factor in 75 percent of the 80,000 new [rental] units constructed" (p. i).

- Between 1976 and 1981 some 131,000 rental units were built in Ontario. Of these, 45,000 were socially-assisted and 86,000 were privately-initiated units (Pringle, 1985, Figure 4.1).

- Housing with ongoing government subsidies (socially assisted housing) account for almost 14% of the province's rental stock (rents or occupancy charges in socially-assisted housing are excluded from rent review legislation) (p. iii).

- In 1972, the Ontario Housing Corporation had 54,097 units of rent-geared-to-income units under management (30,784) for families and 23,313 senior citizen units). In 1976 the total was 89,075 (43,010 for families and 46,065 for senior citizens). By 1982 the total was 115,524 (47,775 for families and 67,749 for seniors) (p. 58). In 1972 98.9% of OHC's units were in project-type developments, but this had declined to 85.9% in 1982 (p. 59). Just over one-half the family households in OHC units in 1982 were receiving social assistance; 39% had income from employment (p. 62). Their incomes averaged $9600 in 1981 (p. 64).

- In addition to the OHC social housing, there were 40,581 private or municipal non-profit rental units in Ontario in 1982 of which 46% were for senior citizens and 53% were for families (p. 72). It should be noted that not all of the persons in such units had low to moderate incomes (p. 69).

4.0 THE CONTROLLED RENTAL STOCK

- In mid-1981 some 77.2% of the occupied rental stock was subject to rent regulation:

- Units subject to rent regulation	839,000	77.2%
- Units not subject to rent regulation		
-- socially assisted units	148,000	13.6
-- new privately initiated construction	86,000	7.9
-- pre-1976 units with $750+/month rent	14,000	1.3

(Pringle, 1985, Figure 4.1).

- The size of exemptions relative to the 1981 rental stock attributable to:

  - the $750/month exemption, and

  - new construction 1976-81

by CMA ranged from 8.3% (Sudbury) to 22.7% (Thunder Bay). The Ontario average was 14.8% and for Toronto CMA it was 13.7$ (Pringle, 1985, Table 4.1).

5.0 VACANCY RATES

- Vacancy rates (the measure of the relative balance between supply and demand in the rental market) have, on average, declined steadily since 1976. The distribution of vacancy rates for ten Ontario CMAs before and after the imposition of rent controls is as follows:

vacancy rate	1971-75	1976-80	1981-84
< 1 %	13%	23%	59%
1.1 - 3.0	54	55	34
3.1+	32	21	8
no. of observations	84	98	80

These data suggest for the past four years that the rental market in Ontario CMAs has been tight or very tight.

- Data for the Toronto CMA in 1983 and 1984 (the only years available) indicate that the vacancy rate in the controlled sector was 0.3 to 0.6% while that in the uncontrolled sector was 2.7% to 6.2%.

6.0 MOBILITY RATES

- The tenant annual turnover rate in Ontario averates approximately 40%. The last comprehensive survey of seven cities in 1980/81 found that between 29% and 45% of tenants had moved during the previous year. The evidence suggests that overall tenant turnover has decreased slightly between 1976/77 and 1982/83 (the last year for which we have data). However, in Metro Toronto the turnover rate fell from 41% in 1976/77 to 29% in 1980/81 and 1982/83.

- Over 60% of homeowners in Ontario did not move between 1976 and 1981. The comparable figure for tenants was 20% (Pringle, 1985, p. 136).

7.0 RENT INCREASES

- Based on surveys in several CMAs almost one-quarter of tenants in Ontario did not experience any rent increase over the previous year in 1977/78, 1978/79, 1979/80 and 1980/81.

- The rent increases granted to landlords appearing before the regulatory authorities between 1976 and 1983/84 substantially exceeded the guideline increase or statutory rate (8% July 1975 to October 1977 and 6% thereafter):

Difference between the average increase granted
and the statutory rate

1976	+ 4.6% pts.
1977	4.5
1978	3.7
1979	5.3
1980/81	5.6
1981/82	8.7
1982/83	8.2
1983/84	4.6

- Between 1976 and 1982 the annual rate of increase in the Toronto CPI exceeded the rate of increase in the rent of one-bedroom apartments as these data indicate:

	Toronto CMA (one-bedrm.)	Toronto CPI	Difference
1984	6.2% Oct.	4.8%	1.4%
1983	6.6	6.0	0.6
1982	10.8	11.3	(0.5)
1981	9.7	12.5	(2.8)
1980	5.5	10.2	(4.7)
1979	8.5	9.2	(0.7)
1978	2.4	8.5	(6.1)
1977	2.9	7.8	(4.9)
1976	4.8	7.3	(2.5)

- If total decontrol of rents occurs on January 1, 1985, Clayton Research (November 1984, p. 70) estimates that between 1982 and 1991 rental households will grow as follows:

1982	4.8%	1987	4.5
1983	4.3	1988	6.0
1984	11.2	1989	8.0
1985	7.0	1990	9.0
1986	4.5	1991	10.0%

- The ratio of average monthly rents to homeownership costs in Toronto has declined steadily from 1963 to 1983. In 1963 the ratio was 0.96. In 1973 and 1974 it was 0.67. By 1980 it had fallen to 0.55 and in 1983 it was 0.51 (Patterson, 1985, p. 72).

- Clayton Research (November 1984, p. 65) provide the following data on average rents and mortgage payments for the Toronto CMA:

	rent	mortage payment	ratio
1971	$157	$210	.75
1981	364	1072	.34
1983	437	911	.48

- Clayton Research (November 1984, p. 64) indicates that average real rents in the Toronto CMA were falling between 1972 and 1975 and between 1978 to 1982.
- While buildings with more than six units accounted for 66% of the rental stock in 1981, they typically accounted for 85% of units granted increases larger than the statutory rates under rent review. See Chapter 6.
- Although small buildings were distinctly underrepresented at rent review hearings, they consistently obtained larger than average increases in rent. Chapter 6 indicates that the owners of smaller buildings typically received three percentage points more than the average increase received for all units. Landlords with elevator buildings (and more than six units) typically received one percentage point less than the average. On the other hand, landlords of buildings with more than six units but without an elevator typically received one percentage point more than the average increase awarded by the regulatory authorities.

8.0 ECONOMIC ENVIRONMENT

The environment of the rental housing market can be described in terms of several basic demographics or by macro-economic variables. The rate of growth of population in Ontario declined from 1.8% in 1974 to 0.71% in 1979. From 1980 to 1983 this trend reversed. Growth rates of real income per capita fluctuated widely throughout the period 1971 - 1982 with sharp declines in 1972, 1975, 1977b and 1982. Generally the rates of growth in real average per capita income rose at an annual average of 4.9% between 1971 and 1975. This annual average rate of growth declined to 2.1% in the period 1976 - 1979. In the period 1980 - 1983 it declined further to 1.0%. Thus the growth in demand for rental housing attributed to external factors appears to have slowed considerably in the second half of the past decade.

The patterns of rates of change in variables affecting supply showed much sharper discontinuities in the past decade. Interest rates on five-year conventional mortgages rose about 17% in 1973 and remained at the higher level until 1977. They declined in 1976 by about 12% and then rose in the subsequent years (1979, 1980 and 1981) by 12%, 20% and 27% respectively. In 1983 interest rates dropped by about 26%.

Other cash costs, in particular energy prices showed also patterns of change with sharp discontinuities. In particular, the periods of 1974 - 1975 and 1980 - 1982 reflected major readjustments in energy prices after the first and second oil crises. The inflationary pressures of these adjustments were reflected in other cost components such as the CPI and nominal wage rates.

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Research Studies

The following is a list of papers commissioned by the Inquiry.

No.

1 Slack, Enid and Sherry Glied. Rent Registry Alternatives.

2 Reid, Frank. Collective Bargaining for Tenants.

3 Jaffary, Karl D. Problems in the Regulation of Rents for Roomers and Boarders.

4 MacDonald, Daniel V. Constitutional Reference Re: The Residential Tenancies Act.

5 Fallis, George. Possible Rationales for Rent Regulation.

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7 Sharp, Campbell, Pannell Kerr Forster Campbell Sharp. Survey of Financial Performance of Landlords.

8 Marks, Denton. Housing Affordability and Rent Regulation.

9 Steele, Marion and John Miron. Rent Regulation, Housing Affordability Problems, and Market Imperfections.

10 Clayton Research Associates Limited. Rent Regulation and Rental Market Problems.

11 Makuch, Stanley M. and Arnold Weinrib. Security of Tenure.

12 Hartle, D.G. The Political Economy of Residential Rent Control in Ontario.

13 Slack, Enid and David P. Amborski. The Distributive Impact of Rent Regulation.

14 Knetsch, Jack L., Daniel Kahneman and Patricia McNeill. Residential Tenancies: Losses, Fairness and Regulations.

15 Stanbury, W.T. Normative Bases of Rent Regulation.

16 Stanbury, W.T. Normative Bases of Government Action.

17 Stanbury, W.T. and P. Thain. The Origins of Rent Regulation in Ontario.

18 Stanbury, W.T. and I.B. Vertinsky. Rent Regulation: Design Characteristics and Effects.

19 Chant, John. Overview of Alternative Rental Housing Policies.

20 Foot, David K. Housing Demands: A Demographic Perspective.

21 Quirin, G. David. Regulatory Systems and their Applicability to Rent Controls.

22 Mascall, M. and Associates. Report of the Ontario Rental Housing Market.

23 Environics Research Group Limited. Financing Residential Rental Accommodation: A Survey.

24 Ekos Research Associates Inc. A Study of Landlords and Rent Regulation.

25 des Rosiers, Francois. A Rent Control System in Quebec.

26 Slack, Enid. The Costs of Rent Review in Ontario.

27 Muller, Andrew. Workable Rent Regulation: A Synthesis.

The following is a list of papers prepared by the research staff of the Inquiry.

28 Adams, Eric B., Pearl Ing and John Pringle. A Review of the Literature Relevant to Rent Regulation.

29 Adams, Eric B., Pearl Ing, Janet Ortved and Mary Jane Park. Government Intervention in Housing Markets: An Overview.

30 Pringle, John. Ontario's Residential Tenancies: A Statistical Profile.